

UNIVERSITY OF NATAL

FOREIGN DIRECT INVESTMENT IN MANUFACTURING TEXTILE AND CLOTHING INDUSTRY FROM CHINA TO SOUTH AFRICA



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**SUBMITTED IN PARTIAL FULFILMENT OF THE EQUIREMENTS FOR THE DEGREE OF
BUSINESS ADMINISTRATION IN THE GRADUATE SCHOOL OF BUSINESS, UNIVERSITY
OF NATAL, DURBAN**

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JUNE 2002**

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EXECUTIVE SUMMARY

International business is much more complicated than domestic business because countries differ in many ways. Countries have different political systems economic systems. Cultural practices can vary dramatically from country to country, as the education and skill level of the population, and countries are at different stages of economic development.

Moreover, development of multinational strategies involves consideration of threats, opportunities, key success factors, and strategy options and issues that do not appear when the analysis is restricted to operations within a single country. In particular, the evaluation of a market must take into account the political and economic risks associated with individual countries. Thus the external analysis becomes much more demanding.

South Africa's trade and industrial policy has moved away from a highly protected, inward-looking economy towards an internationally competitive system that is able to capitalize on its comparative advantages. Enhancement of the competitiveness of industries on the domestic and international markets has consequently become a prime focus of the country's industrial policy.

International trade in textiles and clothing is conducted on an immense scale. Textile and clothing producers were responsible for 9.3 per cent of world exports of manufacturers in 2001. Barriers to entry for new firms and exporters are low, and consequently the degree of international competition is intense. Competitive advantage is very difficult to sustain for long periods of time. Newcomers speedily challenge successful exporters of basic products, and they must redirect their activities towards the production of higher value-added textiles and clothing in order to survive and prosper.

As a world's fifth largest trading power, China economy expands promptly through their expert skills on technology, management, and labour-intensive products. Today,

China represents between 5 to 10% of global output, their export market will continue to grow rapidly, and not only for their labour intensive products, but also for the higher technology goods and services that are an increasing proportion of China's output as it climbs up the production ladder. Textile industry represents a main role towards China's economy. However, due to the fast-moving pace of globalisation, it has increased the maturity on the product-life cycle of the industry.

Multi-national organizations from China have a choice to extend their global reach, due to the government export incentive programme, the maturity companies can diversify their firms to emerging market in order to exploit their technological advantages and invest internationally. If firm's primary goal is to maximize their shareholder's value, then they and probably the economy are better off if they invest where they can earn the best return.

As they do so, change in the global macro-environment further confounds the choices inherent in building a strategic organization. Some understanding of the organization's external and internal environment always drives strategy, as an international organizational better choice.

In the most general sense, the long-run monetary benefits of doing business in South Africa are a function of the size of the textile and clothing market, the present wealth (purchasing power) of consumers in the market, and the likely future wealth of consumers. Also the Chinese's multi national companies can have the opportunity to gain export market in USA, Canada, Europe and other trade countries in South Africa.

In order to achieve economic growth and competitiveness in South Africa, it is recommend that the several issues cutting across the textile industrial sector need to be addressed through knowledge transfer, training, investment and management. Develop innovative technologies to strengthen the competitiveness.

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CHAPTER 1

INTRODUCTION

The more opportunities that I seize,
The more opportunities that multiply before me
Sun-Tze's The Art of War

1.1 INTRODUCTION

A multinational corporation from China have taken a strategic decision to invest in an emerging economy, by setting up a subsidiary in South Africa. This subsidiary will be involved in the manufacture of footwear and clothing apparel.

Broad economic, macroeconomic and development factors have been used as a basic for the selection criteria in making the recommendation. These criteria determine South Africa's market attractiveness as a host for the foreign investment imitative.

The chapter will commence with the background, value of the study, limitation, and research methodology. Providing an insight into one of the major industries of the world, this research will be of interest to the foreign investors interested in the textiles and clothing sector.

1.2 BACKGROUND

The textile and clothing industry in South Africa occupies an important role within the country's economy. Together, textiles and clothing account for about 14% of manufacturing employment and represent South Africa's second largest source of tax revenue. The industry directly employs 230,000 and another 200,000 in dependent industries such as transport and packaging. The Industrial Development Corporation (IDC) has calculated that for every worker in the textile industry, 2.5 jobs are generated in related industries.

According to SA Stats, total South African retail apparel sales exceeded R24.1 billion in 1997. It represents a 258% increase in retail sales since 1990 and a 146% growth since the elections in 1994. In 1997, the textile industry sales were R 11.9 billion. Global shifts in the clothing and textiles sector exemplify many of the intractable issues facing today's world economy, particularly the tensions caused by rapid and sweeping trade liberalization, increased international competitiveness, dumping and illegal imports.

The Agreement of Textiles and Clothing (ATC) govern the textile and clothing trade among the World Trade Organization (WTO) members and it came into force with the WTO agreement on 1st January 1995. This agreement means that, alongside the progressive application of GATT rules, there will be a progressive phasing out of quotas in the European Union (EU), United States (US) and Canada. The quotas were inherited as per the Multi-fibre Arrangement, which has a 10-year period that ends on 1st January 2005. Upon expiration of ATC, all quotas will be abolished. This implies that in 2005 all WTO members will have unrestricted access to the EU, US and Canadian markets.

In turn this means that the EU and other countries affected by the quota arrangement must enter into reciprocal trade liberalizations initiatives so that textiles and clothing markets world-wide are open to the same extent as the EU market in 2005.

It is therefore imperative that multinational companies (MNC) from China need to make a positive contribution to the economic growth of developing countries through their investment and services. This can be achieved:

- By translating theoretical knowledge into practical results by the correct use their products and services, for textile, clothing and the industry;
- Providing access to modern technological and management know-how (e.g. Research, development and marketing)
- Investment and employment
- Training in all operational and hierarchical levels.

For these reasons, SAG is committed to FDI support and has created incentives for foreign companies to invest into South Africa's vast interior where markets are under-served. In October 1, 1996, SA introduced an incentive scheme as part of the Small/ Medium Manufacturing Development Program (SMMDP). The incentive package provides for an establishment grant payable for three years on qualifying assets and a profit/output incentive payable for an additional years. It can be able to attract more Chinese companies to invest into manufacturing textile and clothing industries with transfer of their expertise skills and technologies in South Africa as a platform and seek the opportunities to export their finished garment into America, Europe and elsewhere.

1.3 MOTIVATION FOR THE RESEARCH

Who would like to invest into South Africa? Investors, who know South Africa and find it to their advantage of doing business here. According to a new study “ Investors who already present in the country have positive perceptions about its potential as an investment destination” (A.T Kiarney, 2000).

S.A proactively seeks foreign direct investment (FDI) as a key part of its macroeconomic policy. President Thabo Mbeki has created a prestigious international investment council to help ensure that S.A is an attractive destination for foreign investment. South African government (SAG) through its investment agency and travels of key ministers has conducted a number of investment promotion efforts in China. The SAG has identified auto components, chemicals, electronics, information technology, pharmaceuticals, telecommunications, textile and clothing and tourism, as priority areas for attracting China investment.

“Increasing FDI requires paying attention to the fundamental determinants of international investment decisions and the underlying macroeconomic expectation which may be relevant. These, might include: political and economic stability, including macroeconomic stability and clarity about economic policy; sustained high rates of economic growth; labor market stability and flexibility; investment incentives; the tariff regime; protection of property rights; and various determinants of expected investment returns’ (www.worldbank.com).

FDI can bring benefits that are vital in an age of increasing international competition. The home country can transfer their high technology, new management methods, and core competences to the host country and able to access to export markets. It generally a way of becoming better “plugged into” the global market place.

Textile and clothing industry is one of the biggest light industries in China, their technique and expertise of their skills are well known in the world. Recently, due to political reasons, Chinese’s government offers incentive to encourage their enterprisers to invest into South Africa. However, the investment programme been delayed and most of the investors are

not willing to take risk invest into S.A due to lack of knowledge and negative perception toward this country.

South Africa (SA) has a substantial textile and clothing market, well-developed financial institutions and capital markets, excellent communication and transport links, liberal repatriation of profits and other earnings, lower labor costs compared to industrialized countries, and inexpensive electrical power and raw materials.

However, the country continues to face with shortage of skilled labor, particularly in professional fields, The skills shortfall is the result of shortcomings in the educational system and departures of skilled labor from South Africa. Companies have little power to lay off workers as well as finding appropriate black staff to fill quotas set by the employment equity legislation.

High AIDS infection levels pose further problems, high levels of crime, fluctuating currencies, nepotism, corruption, and multiple layers of obstructive bureaucracy all frustrate businesses in Africa.

To have a proper business plan proposal is important before any foreign business invest into host country. For this reason, in order to avoid the conflict between China and South Africa, the motivation for this research is seek to have more in depth knowledge of S.A market. For instance, the South African Market, Trade and exchange rate policy, Transparency of the regulatory system, labour costs, political risk and textile tariff.

1.4 VALUE OF THE STUDY

Managing an international business is different from a domestic business for at least four reasons:

- (1) Countries are different,
- (2) The range of problems confronted by a manager in an international business is wider, and the problems themselves more complex than those confronted by a manager in a domestic business,
- (3) An international business must find ways to work within the limits imposed by government intervention in the international trade and investment system, and
- (4) International transactions involve converting money into different currencies.

This study examines the feasibility of setting up subsidiary company for the purpose of the textile and clothing industry in South Africa from China. Promoting FDI into S.A, at the same time it can create more employment and revenue into the country.

The questions that are pertinent in this study:

- What kind of problems do the foreign companies need to face in South Africa?
- What factors govern their success or otherwise?
- What kinds of strategies need to be implemented?

1.5 RESEARCH METHODOLOGY

By answering the above questions the dissertation will bring in available theory, e.g. PEST analysis, Porter's diamond and Porter's five forces with practice together and add to the growing literature in the field.

Both desk and field research will be carried out. Desk research will focus on examine the literature on the FDI. Field research will use a case study approach by identifying a business where the role of strategies will be examined.

The main resources required will be different literature, including magazines, newspapers, reports and textbooks etc.

1.6 LIMITATIONS OF RESEARCH

In this research, the focus will only be on KwaZulu-Natal's environment because the majority of textile manufacturers are based in this province. The economy, cultural and demographic issue and related issues will be analyzed of this province.

1.7 STRUCTURE OF RESEARCH

The research is divided into five parts. Attention will be focussed to provide an understanding of the complex and diverse South Africa business environment. In the first instance the background, value and research methodology of study will be presented

The second part, Introduction and Overview, presents and introduction of the concepts, methods, and strategy alternatives discussed and used in the book, including the concept of a business strategy. It also provides an overview of strategic decisions based on a comprehensive flow model that serves to structure the book.

The third part, Environment Analysis, which presents the analytical approach for understanding the phenomenon. It provides a way of viewing the distinctive nature of industry structure. How South Africa differs from China with regard to their political, economic, legal, and cultural institutions.

The fourth part, Strategy Evaluation and Selection, define and select the most appropriate entry mode. Included are discussions and illustrations of alternative ways of obtaining sustainable competitive advantages by low cost or differentiation strategy.

The final part, Recommendation and Conclusion, concludes by briefly discussing trends affecting the future business environment in South Africa.

CHAPTER 2.

THE FRAMEWORK OF STRATEGY

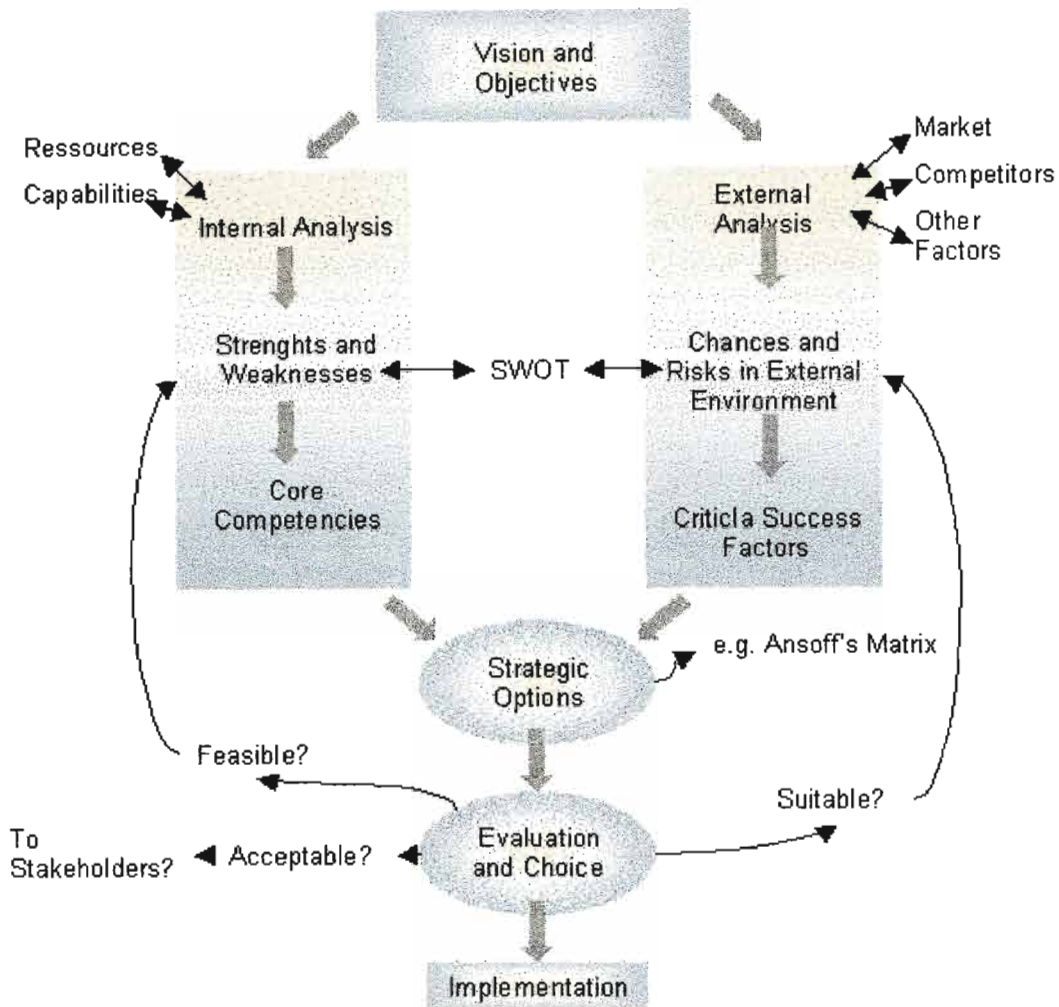


Figure 2.1 Strategic processes — derived from Mintzberg: Strategy Safari

2.1 INTRODUCTION

If we wish to increase the yield of grain in a certain field and on analysis it appears that the soil lacks potash, potash may be said to be the strategic (or limiting) factor.

(Chester I. Barnard, 1934)

The term “strategy” ...is intended to focus on the interdependence of the adversaries’ decisions and on their expectations about each other’s behavior.

(Thomas C. Schelling)

Strategy can be defined as the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out those goals.

(Alfred D Chandler, Jr, 1963)

In spite of thoughtful attempts over the decades to define ‘strategy’, a rash of manifestos continue to emerge that purport to redefine the term. The word strategy is derived from the Greek word ‘Strategia’ that was used around 400 B.C, which connoted the art and science of directing military forces. The early history of business strategic thinking was affected in many ways by military concepts and considerations.

Today, strategy defines as unifies, comprehensive, and integrated plan that relates the strategic advantages of the firm to the challenges of the environment. It is designed to ensure that the basic objectives of the enterprise are achieved through proper execution by the organization.

Overall, strategy is about winning in the marketplace to attract winning and retained customers, and outperforming competitors. It requires the organization to create or leverage change in the environment by continually adapting its product offerings and by modifying and enhancing how it competes. It must anticipate changes in competitive conditions – the entry of new types of competitors, the introduction of new products, technology developments, and changes in customer’s taste.

2.2 GLOBAL MARKET

“Thinking [about] complements is a different way of think about business. It’s about finding ways to make the pie bigger rather than fighting with competitors over a fixed pie. To benefit from this insight, think about how to expand the pie by developing a new complements or making existing complements more affordable.”

(Brandenburger and Nalebuff, 1996)

Due to rapid advancements in technology, particularly related to transportation and telecommunications, globalization increases markedly during the 1990s. The shift from previous individual national economies to an integrated global economy created challenges and problems for those companies extending into several countries. For a company to be successful in such an environment it is necessary to take the differing business and competitive environments into consideration when selecting strategic options. This creates opportunities and challenges, such as deciding where to base operations to leverage cost advantages and to take advantage of national differences in the cost and quality of the necessary factors of production. The reduction of world trade barriers has allowed companies to take advantage of such opportunities.

Countries across the globe are different due to the various economic, legal and political systems shaping them. To be successful in international business it is important that all employees understand the mindset necessary for successful implementation of international strategy and that a company develops a corporate culture reflecting the global markets in which it operated.

The attraction of foreign investment is a key objective of Southern Africa (S.A). S.A has traditionally attracted mainly market and resource seeking foreign direct investment (FDI). In spite of government’s recent commitment to fiscal austerity and liberalization, and its marketing of Department of Trade and Industry Policy Support Programme (DTI PSP). S.A’s current is establishing much efficiency seeking manufacturing FDI.

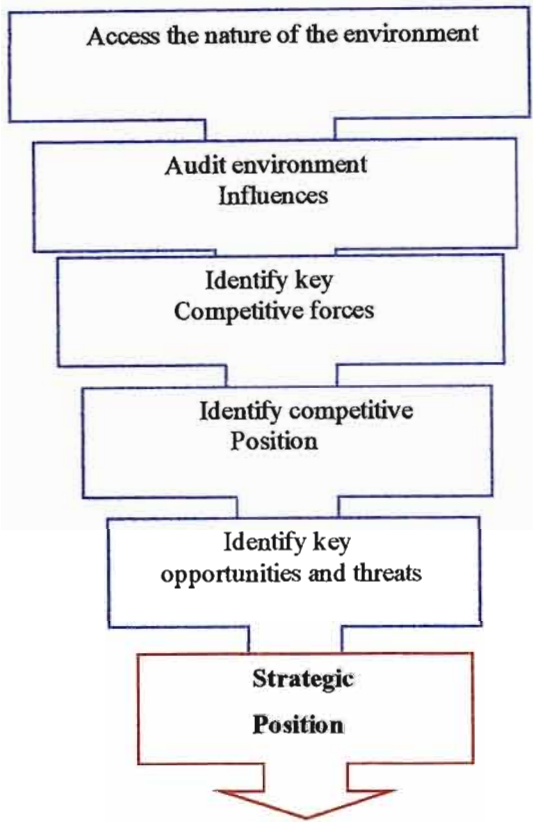
Foreign Multi-National Company (MNC) is confronted by the need for up-to-date and reliable investment intelligence to inform their choice. Therefore, it is the essential for

those companies to build themselves with the collective knowledge on this highly volatile micro and macro Southern Africa's environment.

In this chapter, attention will be focussed on the process of analysing environment strategy (Figure 2.1). The reason being is environment encompasses every aspect external to the organization itself: not only the economic and political circumstances, which may vary in being aggressive to a greater or lesser degree. MNC therefore needs to develop corporate strategies that are best suited to their core competencies in relation to the environment in which they operate.

2.3 ANALYSING THE ENVIRONMENT

Figure 2.2 Steps in environment analysis



Source: EXPLORING CORPORATE STRATEGY

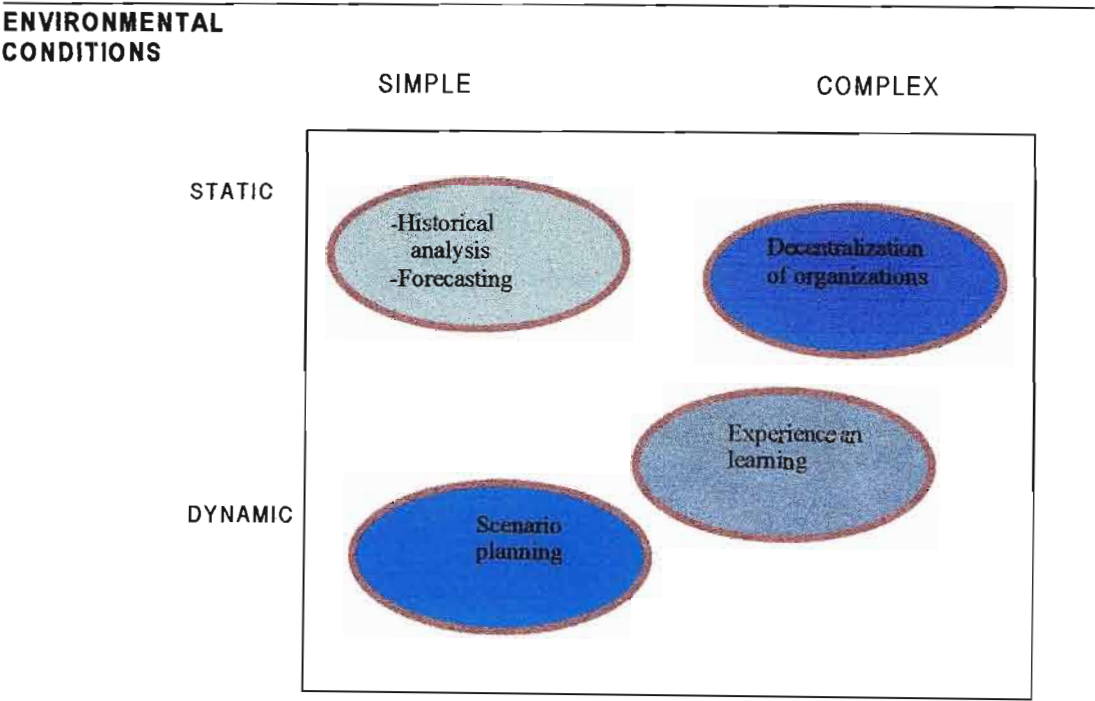
The frameworks of formulating competitive strategy are relating a company to its environment. It is useful to take an initial view of the nature of the industry's environment in terms of how uncertain it is. The macro environmental influences the organization's development and performance, therefore it is essence to audit the environment influences which involves identifying the political, economic, social and technological. It is known as a PEST analysis. Forces outside the industry are significant primarily in a relative sense, since outside forces usually affect all firms in the industry, the key is found in the differing abilities of firms to deal with them. It is also important to understand your competitor's position in relation to the attractiveness of the market in which it operates.

The aim of the environmental analysis is to develop an understanding of opportunities that can be built upon, and threats, which have to be overcome or circumvented according to the organization competence and their resource base. These frameworks are briefly illuminates in Figure 2.2.

2.4 UNDERSTANDING THE NATURE OF THE ENVIRONMENT

How to lay the foundation for tomorrow’s success while competing to win in today’s marketplace? “Winning today is never enough; unless the seeds of tomorrow’s success are planted and cultivated, the organization will not have a future” (Fahey 1982). The environment in which tomorrow’s success will be earned is likely to be quite different from the environment that confronts the organization today. Foreign investors need to understand the uncertainty of the environment that they will pool their capital into that country.

Figure 2.3 Approaches to making sense of the environment



Environmental conditions can distinguish into four conditions, such as stable, dynamic, simple or complex. Environmental uncertainty increases the more the conditions are dynamic or complex, and the approach to making sense of this may differ both by the extent to which the environment is stable or dynamic, and also the extent to which it is simple or complex, as shown in Figure 2.3 .

When the environment is in a simple/static condition, that means this environment is not undergoing significant change. Even though if change does occur, it is likely to be predictable, so it can analyze the environment extensively on an historical basis as a means of trying to forecast likely future conditions.

If it is in the dynamic situation, investors have to consider the environment of the future, not the past. They may need to use scenarios planning to view the different possible futures. The plan will be based on groupings the key environmental influences and drivers of change about which there is a high level of uncertainty.

Organization in complex situations faces an environment difficult to follow. It is difficult to handle complexity by relying primarily on analysis. Complexity as a result of diversity might be dealt with by ensuring that different parts of the organization responsible for different aspects of diversity are separate, and given the resources and authority to handle their own part of the environment.

**2.5 MACRO ENVIRONMENTAL ANALYSIS:
AUDITING ENVIRONMENTAL INFLUENCES**

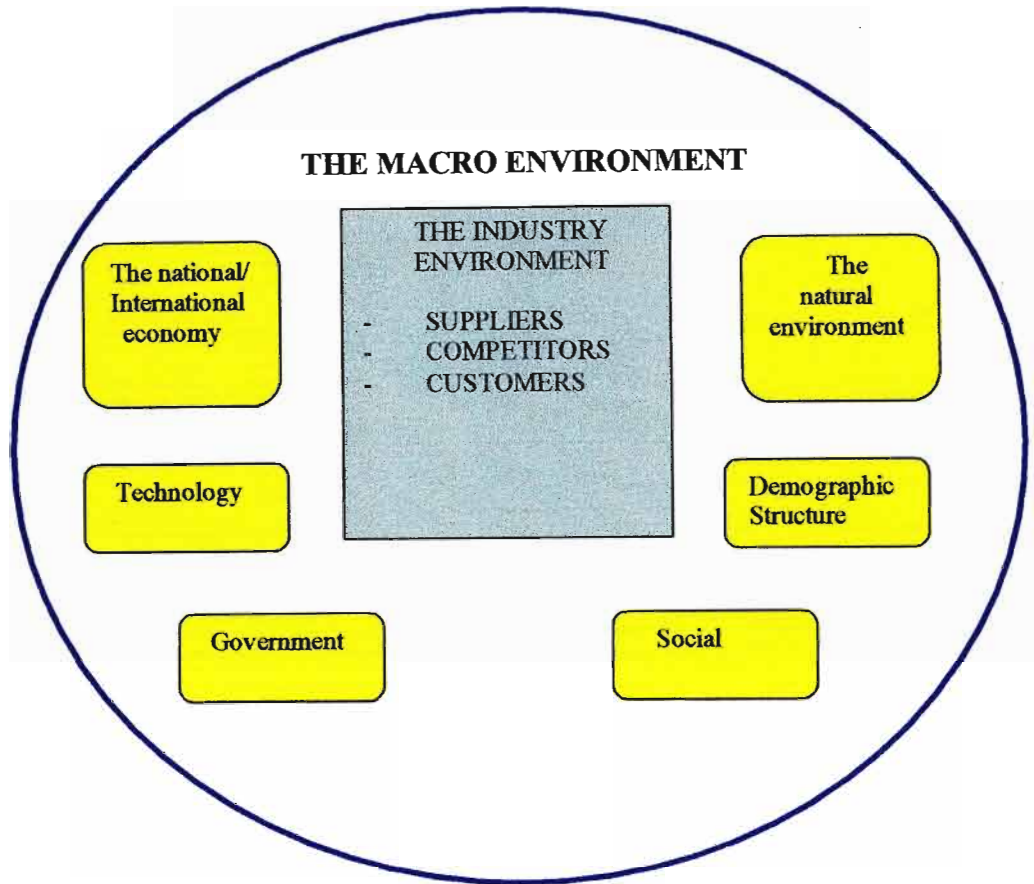


Figure 2.4 The Business Environment

A corporate acts minute-by-minute in a micro environment that is represented by its operations, markets, and industry. The macro environment at times change rapidly and organisations either react or at times they are proactive.

To succeed in the new environment of tomorrow, the organization itself must undergo significant and sometimes radical change. Old ways of thinking have had to be challenged and reconceived when long held assumptions and beliefs ultimately have become incongruent with the changed environment. New operating processes or ways of doing things must be learned.

The prerequisite for effective environmental analysis is to distinguish the vital from the merely important. From the point of view of the firm, the core of its environment is its network of business relationships. These relationships comprise transactions with rival producers. Hence, competitors, suppliers, and customers form the core of the firm's environment. This arena is the firm's industry environment in Figure 2.4.

Foreign companies need to scan the environment in order to identify indicators or precursors of current and potential change and issues in the social, political, technological, and economic environments. It is sometimes known as a PEST analysis. One of the intend scanning is to alert the organization to predictable head-on collisions with its environment so that it will have as much time as possible to consider alternative actions. It is equally important that scanning be sensitive to consider new opportunities.

Political Environment

The political segment incorporates all electoral processes and the administrative, regulatory, and judicial institutions that make and execute society's laws, regulations, and rules, for example:

- Monetary and fiscal policies and their impact on price trends and inflation
- Commercial policies such as tariff controls, import restrictions
- Export controls and restrictions on trade

Economic Environment

The economic environment refers to the nature and direction of the economy in which business operates. It includes the stock of physical and natural resources and the aggregation of all the markets where goods and services are exchanged for payment. Economic activity is reflected in levels and patterns of industrial output, consumption, income and savings, investment, and productivity. Changes in the overall level of economic activity directly affect supply and demand in almost all industry.

- Population and its distribution

- Level of economic development
- National income in real terms
- Labor supply and wage rates
- Balance of payments equilibrium
- Exchange controls

The Social Segment

This segment consists of the demographics, life-styles, and social values. An analysis of this segment consists shifts in the structure and mobility of the population, how life-styles are changing, and whether social value change is taking place.

Factors that may also be considered are:

- Literacy and education levels
- Business, economic and technical education available
- Religious, racial and national characteristics
- Degree of urbanization and urban-shift

The Technological Environment

It is concerned with the level and direction of technological progress or advancements taking place in a society, including: new products, processes or materials, general level of scientific activity, and advances in fundamental science.

To understand the concept of Micro and Marco environment, it is helpful to visualize the industry's environment. Without a clear and purposeful understanding of how possible futures in the PEST environments may affect evolution of individual industries.

2.6 PORTER’S DIAMOND – Determining Factors of National Advantage

“National prosperity is created, not inherited. It does not grow out of a country’s natural endowments, its labor pools, its interest rates, or its currency’s value, as classical economics insists” (Porter, 1990).

Michael Porter (1990) introduced a model that allows analyzing why some nations are more competitive than others are, and why some industries within nations are more competitive than others are, in his book *The Competitive Advantage of Nations*. This model of determining factors of national advantages has become known as Porter’s diamond (Figure 2.5). It suggests that the national home based of an organization plays an important role in shaping the extent to which it is likely to achieve advantage on a global sale. This home base provides basic factors, which support or hinder organizations from building advantages in global competition. Porter distinguishes four determinants:

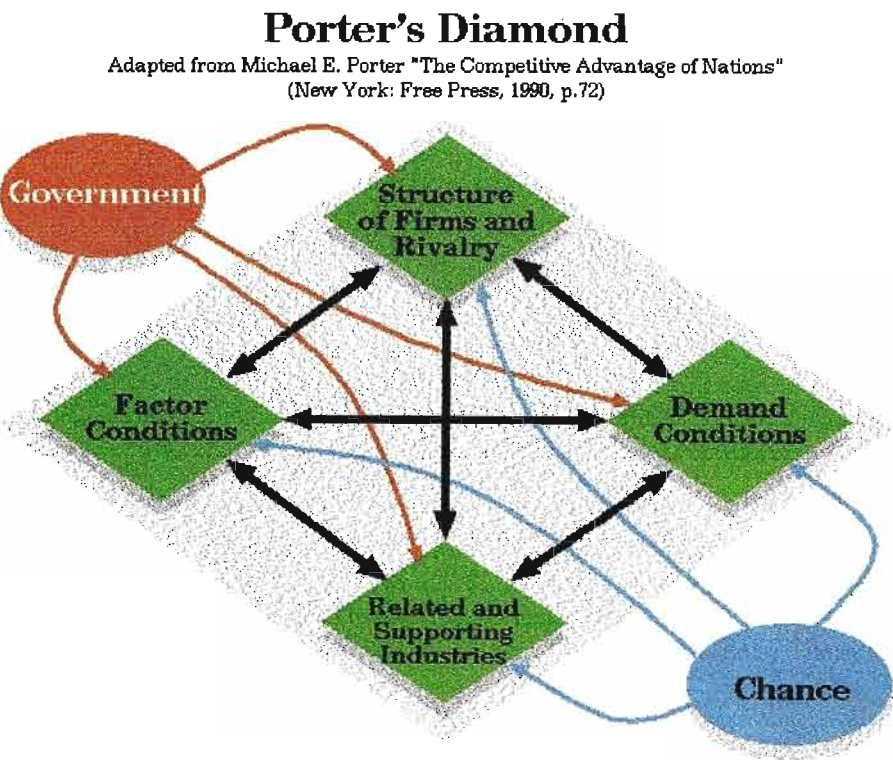


Figure 2.5 The determinants of national advantage (Porter’s diamond)

According to Porter's (1990) theory if the elements in the diamond are increasingly present, trade increases.

Factor Conditions

The situation in a country regarding production factors, like skilled labor, infrastructure, etc., which are relevant for competition in particular industries.

These factors can be grouped into human resources (qualification level, cost of labor, commitment etc.), material resources (natural resources, vegetation, space etc.), knowledge resources, capital resources, and infrastructure.

These national factors often provide initial advantages, which are subsequently built upon. Each country has its own particular set of factor conditions; hence, in each country will develop those industries for which the particular set of factor conditions is optimal. This explains the existence of so-called low-cost-countries (low costs of labor), agricultural countries (large countries with fertile soil), or the start-up culture in the United States (well developed venture capital market).

Porter (1990) points out that these factors are not necessarily nature-made or inherited. They may develop and change. Political initiatives, technological progress or socio-cultural changes, for instance, may shape national factor conditions.

Home Demand Conditions

- Describes the state of home demand for products and services produced in a Country.
- Home demand conditions influence the shaping of particular factor conditions. They have impact on the pace and direction of innovation and product development. According to Porter, home demand is determined by three major characteristics: their mixture (the mix of customers needs and wants), their scope and growth rate, and the mechanisms that transmit domestic preferences to foreign markets.

Porter(1990) states that a country can achieve national advantages in an industry or market segment, if home demand provides clearer and earlier signals of demand trends to domestic suppliers than to foreign competitors. Normally, home markets have a much higher influence on an organization's ability to recognize customers' needs than foreign markets do.

Related and Supporting Industries

- The existence or non-existence of internationally competitive supplying industries and supporting industries.

One internationally successful industry may lead to advantages in other related or supporting industries. Competitive supplying industries will reinforce innovation and internationalization in industries at later stages in the value system. Besides suppliers, related industries are of importance. These are industries that can use and coordinate particular activities in the value chain together, or that are concerned with complementary products.

Firm Strategy, Structure, and Rivalry

- The conditions in a country that determine how companies are established, are organized and are managed, and that determine the characteristics of domestic competition

Cultural aspects play an important role. In different nations, factors like management structures, working morale, or interactions between companies are shaped differently. This will provide advantages and disadvantages for particular industries.

Typical corporate objectives in relation to patterns of commitment among workforce are of special importance. They are heavily influenced by structures of ownership and control. Family-business based industries that are dominated by owner-managers will behave differently than publicly quoted companies.

Porter (1990) argues that domestic rivalry and the search for competitive advantage within a nation can help provide organizations with bases for achieving such advantage on a more global scale.

Accordingly to Porter (1990), the government plays an important role to influences all four of determinants through a variety of actions:

- Subsidies to firms, directly (money) or indirectly (infrastructure)
- Tax code as applicable to firms (corporate income tax, ancillary business and property taxes)
- Regulation and deregulation of capital markets and foreign exchange controls
- Education policies that affect the skill level of workers

- Establishment of technical standards and product standards, including safety and environmental regulations
- The government's purchase of goods and services
- Antitrust regulation
- Encouraging vertical co-operation between suppliers and buyers on a domestic level.

One of the characteristics of the diamond framework is that it makes an explicit link between microeconomic and macroeconomic factors. When the diamond framework is used to investigate long-run industrial change, it is necessary to consider the interaction between the business history of particular firms and the economic history of the nation.

2.7 IDENTIFY KEY COMPETITIVE FORCES:
PORTER’S FIVE FORCES

“Know the other and know yourself:
Triumph without peril.
Know Nature and know the situation:
Triumph completely” (Sun Tzu 300 B.C).

Porter’s five forces model is one of the most effective and enduring conceptual frameworks used to assess the nature of the competitive environment and to describe an industry’s structure. Figure 2.6 shows how these five forces interrelate to determine an industry’s attractiveness. A highly attractive industry is one in which it is comparatively easy to make profits; an unattractive industry is one where profitability is frequently low or consistently depressed. The interrelationships along these five forces give the industry of its own particular competitive environment.

Competitor Categories	Competitive Forces
Actual competitors	Intensity of rivalry
Potential competitors	Barriers to entry
Potential substitutes	Substitution pressures
Suppliers	Supplier bargaining power
Buyers	Buyer bargaining power

Force 1: The Intensity of Rivalry

The intensity of rivalry is the most obvious of the five forces in an industry. It is only one of the several forces that can determine industry attractiveness. If competitors have diverse objectives or attach high strategic stakes to their positions in an industry, they are likely to compete aggressively within it.

Force 2: The Barriers of Entry

One of the most potent forces affecting industry dynamics is the threat of entry of new competitors. New entrants pose a substantial threat when they are easily able to enter a market and when they are able to compete strongly through costs or other means. Some barriers reflect intrinsic physical or legal obstacles of entry, for instance government policy,

economies of scale, capital requirements, and access to distribution or proprietary learning curve.

Force 3: The Threat of Substitutes

The existence of substitutes that perform the same functions as the products or services being analyzed is a basic condition that caps the amount of value an industry can create. The analysis of the threat of substitutes can analysis on demand side, which it must focus on the customer function performed, not just on physically similar products.

Conceptually, analysis of the substitution possibilities open to buyers should be supplemented with consideration of the possibilities available to suppliers. Supply-side substitutability affects suppliers' willingness to provide required inputs, just as demand-side substitutability affects buyers' willingness to pay for products.

Force 4: Buyer Power

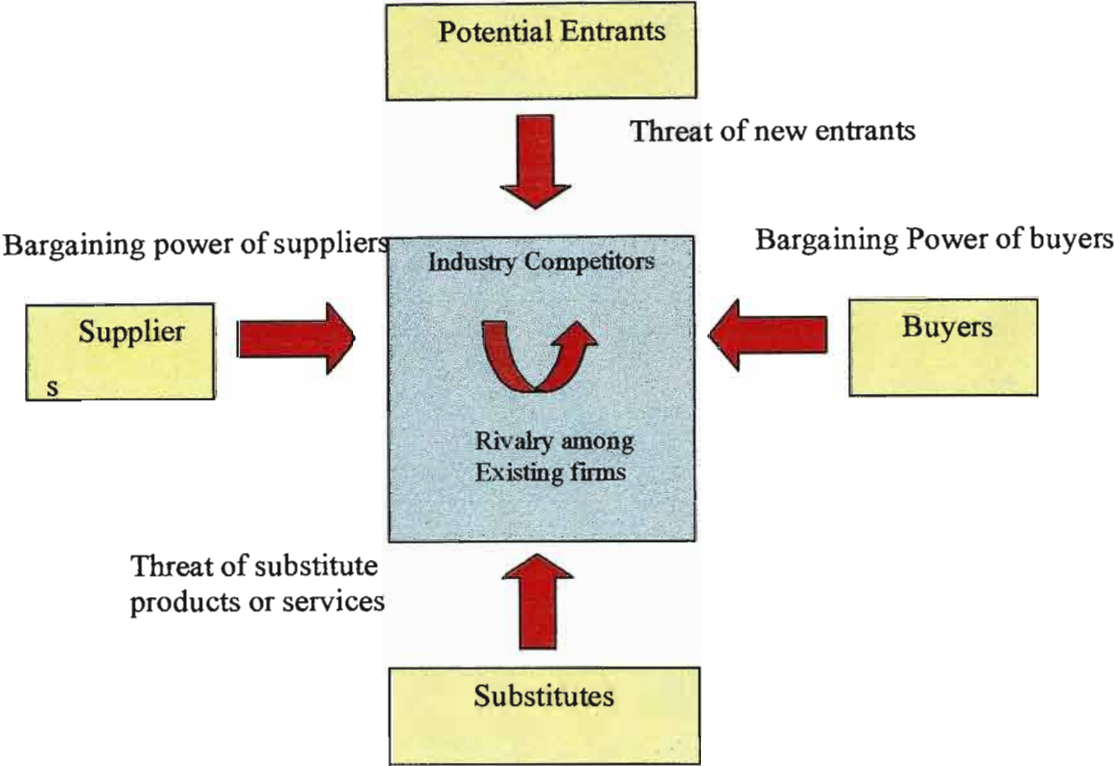
Buyer power is one of the two vertical forces that influences who appropriate the value created by an industry. Buyer power allows customers to squeeze industry margins by pressing competitors to reduce prices or to increase the levels of service offered without recompense.

Force 5. Supplier Power

Supplier power is the mirror image of buyer power. The analysis of supplier power focuses, first, on the relative size and concentration of suppliers relative to industry participants and, second, on the degree of differentiation in the inputs supplied.

Buyer and supplier power must always be balanced with the recognition that relationships between buyers and suppliers have important cooperative as well as competitive elements.

Figure 2.6 Forces driving industrial competition



The aim of competitive analysis is to identify the competitive pressures associated with each force, determine whether these pressures add up to a strong or weak competitive force in the market place. Further their think strategically about what sort of competitive strategy, given the “rules” of competition in the industry, the company will need to employ to (a) insulate the firm as much as possible from the five competitive forces, (b) influence the industry’s competitive riles in the company’s favor, and (c) gain a competitive edge.

2.8 IDENTIFY COMPETITIVE POSITION

Competition provides the rationale for strategy because without it there can be no game plan. It is concerned only with establishing objectives, forecasting the external environment, and planning resource developments. The essence of strategy is the interdependence of competitors. Because actions by one player affect outcomes for other participants, each player's decisions must take account of other player's expected reaction.

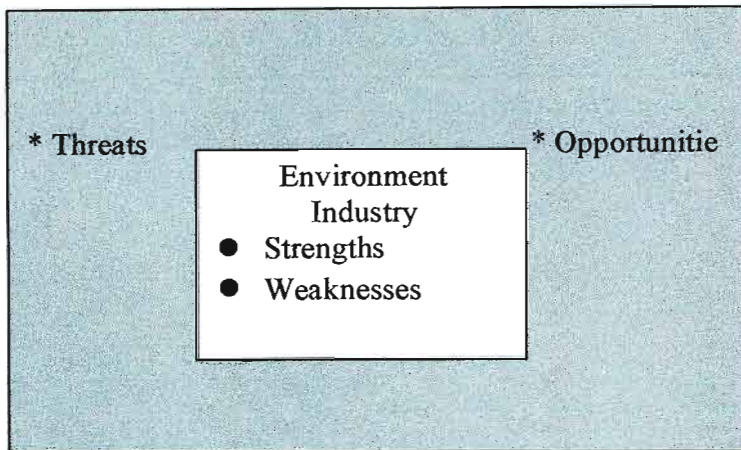
It is therefore important that to understand the organization's competitive position and its implications in strategic terms. One technique for revealing the competitive positions of industry participants is strategic group analysis, the aim to identify organizations with similar strategic characteristics, following similar strategies or competing on similar bases. It able to help identify who the most direct competitors are, on what basic competitive rivalry is likely to take place within strategic groups.

2.9 IDENTIFY KEY OPPORTUNITIES AND THREATS

The final output of the industry analysis is the identification of key opportunities emerging from the favorable factors affecting the industry and the key threats resulting from the adverse impact to industry attractiveness. The better the market opportunity; higher the long run average profitability of all the players in the market. These opportunities and threats should be the depositories of all of the critical issues detected during the environmental scanning process.

Excellent companies have developed the ability to interact effectively with their external environment, either by adapting themselves faster than their competitors, or by capturing opportunities that others have failed to recognize. This ability involves a thorough knowledge and a learning capability to anticipate environmental trends and to place the right bets on the uncertain outcomes associated with them. It all boils down to intelligent risk taking (Figure 2.7).

Figure 2.7 SWOT Analysis



This approach enhances the benefits of the framework, in particular by:

- Thinking through when future changes might occur and the resultant opportunity or threat.
- Challenging managers' mindsets about when an environmental change is an opportunity or a threat
- Matching external changes with internal repercussions, and attempting to gauge the size of the internal impact and identify key priorities for strategic attention.
- Providing a format for thinking about competitive positioning by comparing the impact of changes on the organization with that on competitors.

2.10 STRATEGIC OPTIONS

The choice of mode for entering a foreign market is a major issue with which international businesses must wrestle. For foreign direct investment’s companies, the Expansion Method Matrix (Figure 2.8) explores in a structured way the methods by which market options might be achieved. By examining the industry’s internal and external expansion opportunities and its geographical spread of activity, it is possible to structure the various methods that are available.

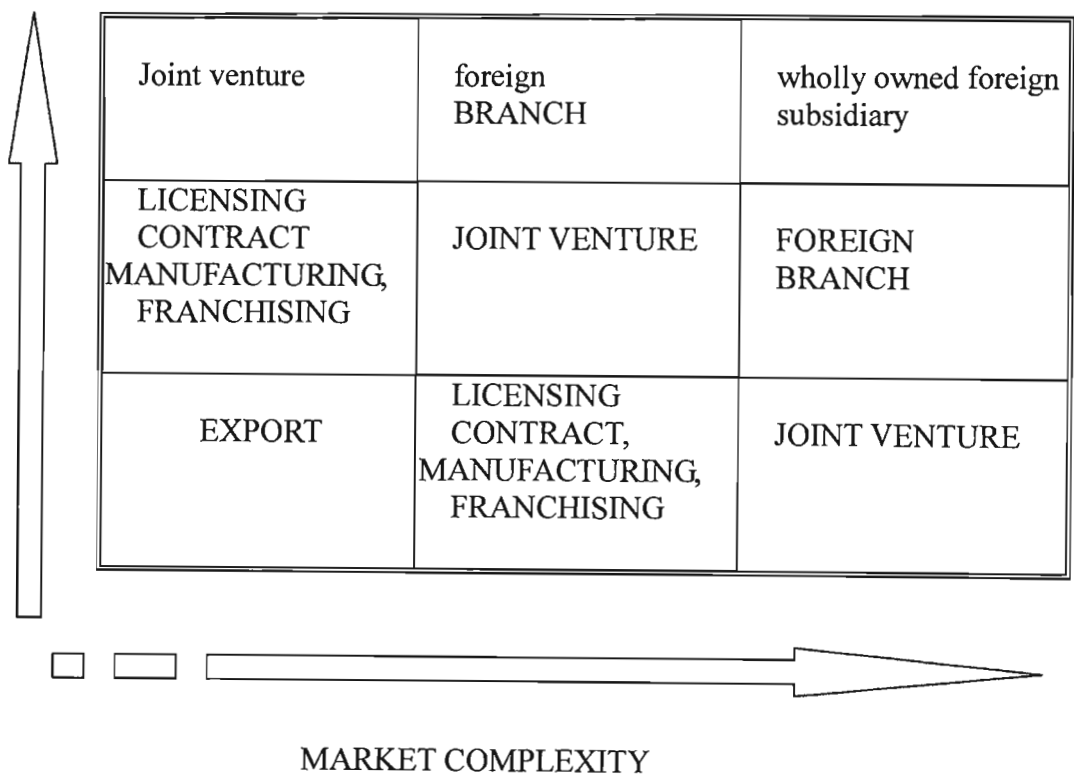


Figure 2.8 The Expansion Method Matrix

The various modes for serving foreign markets are exporting, licensing or franchising to host-country firms, establishing joint ventures with a host-country firm, and setting up a wholly owned subsidiary in a host country to serve its market. Each of these options has advantages and disadvantages. The magnitude of the advantages and disadvantages (see Table 2.1) associated with each entry mode are determined by a number of factors,

including transport costs, trade barriers, political risks, economic risks, and firm strategy. Ultimately, the choice must be based on an assessment of a nation's long run profit potential.

Table 2.1 Advantage and Disadvantage of Entry Mode

Mode	Conditions Favoring this Mode	Advantages	Disadvantages
Licensing	Import and investment barriers Legal protection possible in target environment. Low sales potential in target country. Large cultural distance Licensee lacks ability to become a competitor.	Minimizes risk and investment. Speed of entry Able to circumvent trade barriers High ROI	Lack of control over use of assets. Licensee may become competitor. Knowledge spillovers License period is limited
Joint Ventures	Import barriers Large cultural distance Assets cannot be fairly priced High sales potential Some political risk Government restrictions on foreign ownership Local company can provide skills, resources, distribution network, brand name, etc.	Overcomes ownership restrictions and cultural distance Combines resources of 2 companies. Potential for learning Viewed as insider Less investment required	Difficult to manage Dilution of control Greater risk than exporting a & licensing Knowledge spillovers Partner may become a competitor.
Direct Investment	Import barriers Small cultural distance Assets cannot be fairly priced High sales potential Low political risk	Greater knowledge of local market Can better apply specialized skills Minimizes knowledge spillover Can be viewed as an insider	Higher risk than other modes. Requires more resources and commitment May be difficult to manage the local resources.

Exporting	Limited sales potential in target country; little product adaptation required		Trade barriers & tariffs add to costs.
	Distribution channels close to plants	Minimizes risk and investment.	Transport costs
	High target country production costs	Speed of entry	Limits access to local information
	Liberal import policies	Maximizes scale; uses existing facilities.	Company viewed as an outsider
	High political risk		

2.11 GENERIC STRATEGY ALTERNATIVES

There are numerous distinctly identifiable basic strategies that an organization may choose to follow. Which of these is most appropriate naturally depends upon several factors, such as the mission and long-range objectives, the growth rates of the related markets, and the competitive position of the company. The most appropriate strategy may, and often does, change from time to time.

According to Porter (1990) every business needs to choose one the generic strategies in order to compete in the market place and gain sustainable competitive advantage. The listing in table 2.2 highlights the contrasting features of these generic competitive strategies.

- * **Cost leadership** – appealing to a broad spectrum of customers base on being the overall low-cost provider of a product or service.
- * **Differentiation** – Seeking to differentiate the company's product offering from rivals' in ways that will appeal to a broad spectrum of buyers.
- * **A Best-Cost Provider** – Giving customers more value for the money by combining an emphasis on low cost with an emphasis on upscale differentiation; the target is to have the best (lowest) costs and prices relative to producers of products with comparable quality and features.

Cost Leadership

Achieving an overall low-cost position usually requires that the company develop some unique advantage or advantages over its competitors. The idea behind an overall cost leadership strategy is to be able to produce and deliver the product or service at a lower cost than the competition. Cost leadership is usually attained through a combination of experience and efficiency. More specifically, cost leadership requires close attention to production methods, overhead, marginal customers, and overall cost minimization.

Table 2.2 Distinctive Features of the Generic Competitive Strategies

Type of Feature	Low-Cost Leadership	Broad Differentiation	Best Cost Provider
Strategic Targets	A broad cross-section of the market	A broad cross-section of the market	Value conscious buyers
Basic of competitive advantage	Lower costs than competitors	An ability to offer buyers something different from competitors	Give customers more value for the money
Product Line	A good basic product with few frills (acceptable quality and limited selection).	Many product variations, wide selection, strong emphasis on the chosen differentiating features.	Good-to-excellent attributes, several-to-many upscale features.
Production emphasis	A continuous search for cost reduction without sacrificing acceptable quality and essential features	Invest ways to create value for buyers; strive for product superiority	Incorporate upscale features and attributes at low cost.
Marketing emphasis	Try to make a virtue out of product features that lead to low cost.	*Build in whatever features buyers are willing to pay for. *Charge a premium price to cover the extra costs of differentiating features.	Under price rival brands with comparable features
Sustaining the strategy	*Economical prices / good value. * All elements of strategy aim at contributing to a sustainable cost advantage – the key is to manage costs down, year after year, in every area of the business.	*Communicate the points of difference in credible ways. *Stress constant improvement and innovation to stay ahead of imitative competitors *Concentrate on a few key differentiating features; tout them to create a reputation and brand image.	Unique expertise in managing costs down and product/service caliber up simultaneously.

Source from Thompson and Strickland

Differentiation Strategies

Differentiation strategies are an attractive competitive approach when buyer preferences are too diverse to be fully satisfied by a standardized product or when buyer requirements are too diverse to be fully satisfied by sellers with identical capabilities. To be successful with a differentiation strategy, a company has to study buyer's needs and behavior carefully to learn what they consider important, what they think has value, and what they are willing to pay for.

Best-Cost Provider

This strategy aims at giving customers more value for the money. It combines a strategic emphasis on low cost with a strategic emphasis on more than minimally acceptable quality, service, features, and performance.

2.12 STRATEGY EVALUATIONS AND SELECTION

*“Unless we change our direction, we are likely to wind up
where we are headed”
(Ancient Chinese Proverb)*

Poor choices of strategic direction are costly. A healthy strategy evaluation process should be an integral part of the planning process – not a single event at the end of the strategy development process. How can the likelihood of bad decision be reduced, and good decisions be encouraged? Strategies can be assessed against three criteria:

- ⇒ Suitability
- ⇒ Acceptability
- ⇒ Feasibility.

2.12.1 Accessing Suitability

Suitability concerns whether a strategy addresses the circumstances in which the organization is operating. Accessing the suitability of strategic options can be a useful basis on which to screen options before more detailed analyses are undertaken concerning the acceptability and feasibility of those options. This process can consist of two stages: first, establishing the rationale/strategic logic for each strategic option in its own right; and second, establishing the relative merits of an option when a number of choices are available through processes for screening options for further evaluation.

2.12.2 Establishing the Rationale/Strategic logic

This can be done in a number of ways, several of which should be used to “test” a strategy. The most appropriate approaches include life cycle and value chain analysis.

Life Cycle Analysis

The strategy a firm selects depends on both the industry environment and its own distinctive competences and strengths. Yet, the evolution of the industry environment can

have a marked impact on how firms build different sources of competitive advantages. The position within the life cycle can be determined in relation to eight external factors or descriptors of the evolutionary stage of the industry. These are: market growth rate, growth potential, breadth of product lines, number of competitors, spread of market share between these competitors, customer loyalty, entry barriers and technology. It is the balance of these factors, which determines the life cycle stage.

Table 2.3 Strategic Guidelines Based on Industry Maturity and Competitive Position				
	Embryonic	Growing	Mature	Aging
Dominant	All-out push for share Hold position	Hold position Hold share	Hold position Grow with industry	Hold position
Strong	Attempt to improve position All-out push for share	Attempt to improve position Push for share	Hold position Grow with industry	Hold position or harvest Harvest
Favorable	Selective or all-out push for share Selective attempt to improve position	Attempt to improve position Selective push for share	Custodial maintenance Find niche and attempt to protect	Harvest Phased withdrawal
Tenable	Selective push for position	Find niche and protect it	Find niche and hang on or phased withdrawal	Phased withdrawal or abandon
Weak	Up or out	Turnaround or abandon	Turnaround or phased withdrawal	Abandon

The purpose of the strategic guidelines (Table 2.3) is to establish the appropriateness of particular strategies in relation to the two dimensions, which consists the market situation and the competitive position. The crucial issue is establishing where an organization is currently positioned and therefore what types of strategy are most suitable.

Value Chain Analysis

Successful companies need a thorough understanding of their industries, not just their business. Maps of industry interrelationships reduce the complexity of, and provide a framework for, understanding the components of the business and making better decisions. The value chain charts the connection between the upstream and downstream components of the business and their relationships to one another. Business processes organize the flow

of an interrelated set of activities, information, and resources along the value chain and, in so doing; help achieve the strategy of individual organizations.

2.12.3 Screening Options

It can be important in screening options before a more detailed assessment of acceptability and feasibility is undertaken. The relative suitability of strategic options can be assessed by:

- 1) **Ranking** method, which the options are assessed against key, factors in the environment, resources and stakeholder expectations.
- 2) **Decision Trees**, which is similar to ranking method. The options are progressively ‘eliminated’ by introducing further criteria
- 3) **Scenario planning**, which attempt to match specific options with a range of possible future outcomes and are particularly useful where a high degree of uncertainty exists.

2.12.4 Analyzing Acceptability

Establishing the suitability of options is a useful starting point to an evaluation as it establishes the foundation or strategic logic behind a particular strategy. However, strategies also have to be acceptable to a variety of different stakeholders. The acceptability of strategies can be assessed in three board ways: return, risk and stakeholder reactions (Table 2.4).

Table 2.4 Assessing the acceptability of strategies – Analyzing return

Approach	Used to assess	Examples	Limitations
Profitability analysis	Financial return of investments	Return on capital Payback period Discounted cash flow (DCF)	Apply to discrete projects Only tangible costs/benefits
Cost-benefit analysis	Wider costs/benefits	Major infrastructure projects	Difficulties of quantification
Shareholder value analysis (SVA)	Impact of new strategies on shareholder value	Mergers/takeovers	Technical detail often difficult

Overall risk reflects the combined threats from both environmental uncertainties and internal uncertainties about the ability of the business to implement the strategy. A risk assessment should not stop with an enumeration of all the things that might go wrong. (Table 2.5). The benefit of this evaluation comes from helping the investors to take preemptive steps to prevent the probability of bad things happening.

Table 2.5 Assessing the acceptability of strategies – Analyzing risk

Approach	Used to Assess	Examples	Limitations
Financial ratio projections	Robustness of strategy	Break-even analysis Impact on gearing and liquidity	
Sensitivity analysis	Test assumptions/robustness	‘What if?’ analysis	Tests factors separately
Simulation modeling	Aggregate impact on many factors	Comprehensive models Risk analysis	Quality of data on causal relationships
Stakeholder reactions	Political dimension of strategy	Stakeholder mapping Game theory	Largely qualitative

2.12.5 Analyzing Feasibility

If the business does not posses the skills and resources it needs, is there time to acquire or develop them before the window of opportunity closes? Financial resources and physical resources are the first constraints against which a strategic alternative is tested. There are numbers of critical approaches can be used to access feasibility (Table 2.6).

Approach	Used to measure	Benefits
Funds Flow Analysis	Funds flow forecast	Forecasting technique
Break Even Analysis	Targets of return (profits)	Simple and widely used technique
Resource Deployment Analysis	Resources and competence of the organization	Indicating the key resources and competence for each strategy.

Table 2.5 Accessing Feasibility

2.12.6 Selection of Strategies

Strategies are selected in many different ways, not just through a formal analytical (planned) approach. It is important to understand the role which formal evaluation will play in difference processes of selection. If new strategies are enforced upon an organization, evaluation still has a place. Organizations that develop incrementally are likely to suffer from strategic drift. Formal evaluation is one way of attempting to minimize this danger whilst acknowledging the preference for incremental or reactive change. It can help to promote learning and communication within the organization.

Many strategic choices are ultimately made by, one individual or a small group who have the authority to make sure decisions. So the role of the ‘analysis’ is to “raise the level of debate’ amongst decision-makers. Table 2.7 provides a summary of the processes for selecting strategies:

Table 2.7 Processes for selecting strategies

APPROACH	DOMINANT PROCESSES	ELEMENTS OF GOOD PRACTICE	DANGERS
Planning	Analytical techniques Tested against objectives Quantifies where possible		No ownership Fragmented analysis Rigidity-lost opportunities Decision-makers disown analysis
Enforced choice	Bend to environmental "pressure"	Assess risk Prepare contingencies	"Victims of circumstances" Evaluation not done
Learning from experience	Reactive moves in separate parts of organization Cultural/Political context Important	Processes need credibility Avenues of challenge Promote inter-unit learning	Fragmented/inefficient Pragmatism Risk of strategic drift
Command	Dominant stakeholder Selects strategies	Inform / educate decision maker Need "completeness" Challenge the paradigm	Incomplete vision Vision institutionalized

2.13 CONCLUSION

Many of the world's national markets are becoming more uniform, and opportunities to enter new markets are increasing, FDI is becoming significant option to force into organization's life. However, it requires firms to deal with a host of unfamiliar elements, including customers in distant locations, governments pursuing different agendas, and competitors possessing unusual capabilities. FDI also brings with it the rise very different competitors, many of them backed by home governments and industrial policies that may radically alter the competitive environment.

In this chapter, we have seen the framework of the strategy. It can assist the MNC from China to understand the industry analysis can establish a particular industry is likely to prove attractive to the "average" competitors and can also shed light on profit difference among the local competitors in that industry. It can present a balanced view, the threats versus the opportunities uncovered during the situation assessment. The better the market opportunity, higher the long term average profitability of all the players in the market. More broadly, industry analysis illuminates the competitive landscape in a way that aids the formulation of effective strategies.

Macro-environmental analysis is useful only to the extent that it results in strategy related action and decisions. The integration of expectation of change and preparation for it does not just happen; it must be made to happen. Change must be managed; choices and alternatives need to be weighed, the consequences and operating issues involved in actions need to be examined, and resources need to be allocated.

From environmental change springs opportunities. Without change of the potential to affect change, organizations would neither confront nor be able to create opportunities. Without a managed flow of new opportunities, organizations cannot grow and prosper; they are destined to decline and die. Unfortunately, change is also the source of threats to the organization's current and potential strategies. Thus organizations must commit

themselves to grappling with change and be able to understand and transforming it into opportunity.

CHAPTER 3
ENVIRONMENTAL ANALYSIS



(www.odci.gov)

3.1 INTRODUCTION

The key to foreign investors effectively manage in less developing countries (LDC) is the capacity to analyse, understand, and manage the external forces enveloping the firm. The LDC's distinctive environment engulfs the firm with a complex multitude of pressures, demands and opportunities. Working within an analytical framework does not guarantee optimal decisions, but it provides a structure for the decision process and the answering of key managerial questions.

The fundamental task in environmental analysis is to identify and understand the channels through which external forces impact the firm. A broad view will be taken of the nature of the sector environment and forces shaping the environment in Southern Africa. Thus, the first step is to sort external forces into four categories of environment factors: political, economic, socio-cultural, demographic and technology.

The second step is industry analysis; it includes an analysis the national comparative advantage. A brief overview of the history will be given of the textile industry in China from the 50s to 90s.

External analysis involves an examination of the relevant elements external to the organization. The analysis should be purposeful, focusing only on what is most important and relevant to strategy development. One output of external analysis is an identification and understanding of opportunities and threats facing the organization. An opportunity is a trend or event that could lead to a significant upward change in sales and profit patterns, given the appropriate strategic response. A threat is a trend or event that will result, in the absence of a strategic response, in a significant downward departure from current sales and profits patterns.

3.2 THE NATURE OF THE TEXTILE AND CLOTHING ENVIRONMENT

Before World War II, the textile industry in South Africa was largely confined to the manufacture of blankets, rugs and sheeting. However, after the war, the sector developed rapidly and today the industry consists of around 300 manufacturers, based mainly in KwaZulu-Natal, the Western Cape, the Eastern Cape and Gauteng.

Activities include the production of synthetic fibres and yarns (especially polyester, nylon and acrylic), the manufacture of home textiles, automotive textiles, apparel textiles and technical/industrial textiles. Recent years have seen major restructuring in the industry. The local industry is facing downsize situation due the South Africa open of the economy.

There have been major changes in ownership of textile companies as the industry has braced itself for the challenges and opportunities of globalisation. The South African Government's 7 years tariff phase down for textiles and clothing was introduced in 1995 and by September 1999, duties had been substantially reduced so that the country was ahead of its WTO commitments.

The changes occurring in the economic ideology in South Africa has shifted toward a more free market orientation. One consequence of this shift in ideology has been adoption of the opening of the South Africa economy to foreign investors. The import incentive programme creating enormous opportunities for foreign investors to invest into the country.

According to Absa's South Africa sectoral outlook 2001-2006 report, textile industry in S.A is considered to be a low business cycle sensitivity and volatility (see Table 3.1) Textiles and Clothing industry is labour intensive sectors that employ significant portions of unskilled labour. They have all fared poorly trying to compete against imports from Asian countries with a superior quality of labour. Productivity improvements have been difficult to achieve. This poor growth was in spite of strong growth in domestic demand for semi-durable goods of this nature. This sector is important because of their potential to

satisfy the need to employ large numbers of unskilled labour. However, it is the poor quality of this category of labour that is preventing their expansion.

Table 3.1 Overall sector risk evaluation

Sectoral sensitivities and exposures	Low	Medium	High
Type of demand - Intermediate goods and services		X	
- Household consumption of goods and services		X	
- Government consumption of goods and services	X		
- Investment in goods and services	X		
Business cycle sensitivity	X		
Business cycle volatility	X		
Capital intensity		X	
Relative share of total exports	X		
Relative competitive advantage	X		
Exchange rate sensitivity	X		
Skill level requirement	X		
Unit labour costs		X	
Multi factor productivity	X		
Unionisation			X
Tariff protection			X

Source ABSA 2001

3.3 DIMENSIONS OF ENVIRONMENTAL ANALYSIS

Attention will be focussed on various factors to place the industry in context.

3.3.1 POLITICAL FACTORS

The first constellation of environmental factors focuses on political variables such as stability, institutions, tax policies and international links.

STABILITY

South Africa today is one of the most sophisticated and promising markets globally. The unique combination of a highly developed first-world economic infrastructure and a huge emergent market economy has given rise to a strong entrepreneurial and dynamic investment environment. This makes the country a logical entry point for foreign trade with and investment in the 14 member countries of the Southern African Development Community (SADC). The SADC Trade Protocol, which has come into effect on 01 September 2000, has been developed to liberalize intra-regional trade. It calls for an 85% reduction of internal trade barriers over eight years. It also contributes towards the improvement of the climate for domestic, cross-border and foreign investment. It aims to enhance the economic development, diversification and industrialization of the region and to ultimately establish a Free Trade Area in the SADC region.

INSTITUTIONS

South Africa is a republic, consisting of a central government and nine provincial governments. It has a bicameral parliament elected every five years (made of the 400-seat National Assembly and the 90-seat National Council of Provinces) under the executive leadership of the President who is elected by the National Assembly. The lower house is elected by proportional representation and the upper house represents the country in nine regions. Other parties include the Inkatha Freedom Party (IFP), the National Party (NP), the Democratic Party (DP), the Freedom Front (FF), the Pan-Africanist Congress (PAC) and the United Democratic Movement (UDM).

TAXATION

South Africa operates on a source-based income tax system rather than on residence. Income is subject to tax if it is from a source within or deemed to be within South Africa. Capital gains tax is implemented, and there are no significant tax incentives as the policy is to provide incentives outside the tax system. Profits remitted by the South African branch of a foreign company to its head office abroad are not subject to withholding tax. Partnerships and joint ventures are not treated as separate taxable entities, and foreign income is not subject to South African tax.

TAX RATES

For companies other than branches of foreign companies:

- The first ZAR 10,000 is taxed at 15%
- Normal tax on taxable income is 30%
- Secondary tax on dividends distributed is 12.5%

For individuals:

- Progressive rates are from 18% to 42%
- Minimum income for tax liability is ZAR 21,011.
- The maximum marginal rate applies to income over ZAR 200,000.

FOREIGN CONTROL POLICY

In general, there are no controls on the removal of investment income or capital gains by non-residents. Dividends may be paid to non-residents without the approval of the South African Reserve Bank (SARB), provided an auditor's certificate shows such dividends are a result of post-tax trading, or realized capital profits.

POLITICAL VIOLENCE

Since South Africa's first non-racial elections April 1994, political violence has decreased dramatically. The second non-racial elections in June 1999 were generally peaceful, with political violence comparatively minimal. The highest incidence of political violence occurred in rural areas of the province of Kwa-Zulu Natal, where there were occasional clashes between supporters of the African National Congress (ANC), the Inkatha Freedom Party (IFP) and the United Democratic Movement (UDM). In May 1999, the ANC and the IFP signed a peace pact, and politically motivated violence has waned. Foreigners have

not been specific targets of political violence.

CORRUPTION AND CRIME

South African law provides for prosecution of government officials who solicit or accept bribes. Penalties for offering or accepting a bribe may include criminal prosecution, monetary fines, and dismissal for government employees, or deportation for foreign citizens.

INVESTMENT INCENTIVES

South Africa supports its stimulatory policies with generous government incentives. Effort to liberalize trade and industrial development has been the country established as a dynamic and internationally competitive investment location. Various financial incentive packages endorsed by the Department of trade and Industry (DTI) are on offer to promote investment and, thereby, to stimulate the economy and reduce unemployment. Such initiatives and measures, capitalizing on existing infrastructure and materials, include the following:

- Tariff reform
- An industrial strategy focusing on the supply side, with key features being small/medium manufacturing
- Reform of the regulatory environment

The accelerated depreciation programme allows qualifying small businesses to deduct the full costs of investments in manufacturing assets in one year instead of over five years. The purpose of the Export Marketing and Investment Assistance scheme is to partially compensate exporters for certain costs incurred in respect of activities aimed at developing export markets for South African products and to recruit new foreign direct investment into South Africa.

No government approval is required to invest, foreign investors are permitted 100 percent ownership, there are almost no restrictions on the form or extent of foreign investment, and there are no controls over the removal by non-residents of investment income.

Transfer of profits and dividends is not restricted, and businesses can be wholly or partly foreign owned, with local participation in business ventures encouraged but not a requirement. There are also liberal tax incentives in the form of deductions for business and operating expenses.

Small, Medium Enterprise Development Programme (SMEDP)

- Investments with a capital value greater than R 3 million.
- Foreign investment Grant (FIG): if relocating from abroad, manufacturers can obtain a tax-free grant of up to USD 250 000 for new machinery.
- Investments with a capital value not greater than R 3 million may qualify for tax free grants over a six year period as follows:
 - An establishment grant of 10.5% a year on the value of qualifying assets, paid quarterly in the first year and annually for the following two years.
 - A profit-output incentive for a further one year on the formula: 25% of profit before tax and incentives subject to a maximum payment equal to the establishment grant of R315 000 per enterprise, whichever is the lesser
 - An extension of the profit-output incentive for a further two years if the enterprise maintains a ratio of 55% labour remuneration to value added.
- Foreign Investment Grant: if relocating from abroad, the manufacturer may obtain a grant of up to USD 5000 for new machinery.

FINANCIAL SCHEMES

Schemes for Export Marketing and Investment Assistance (EMIA) and Export Credit and Foreign Investment Reinsurance are aimed at providing prospective exporters with financial assistance. The EMIA comprises export marketing research, foreign direct investment research, outward-selling and investment research, outward-buying and investment missions, inward-buying and investment missions, and foreign exhibitions. The EMIA also offers assistance to industry-specific sectors and includes a special dispensation for SME exporters. An Export Credit Finance Guarantee scheme for SMEs has also been introduced. The Export Finance Scheme for Capital Projects is popular among financial

institutions and contractors, with exporter able to compete internationally by offering reasonable repayment rates denominated in US dollars to prospective overseas buyers.

INTERNATIONAL LINKS

The European Union (EU) and South Africa have signed a Trade, Development and Co-operation Agreement, which include a Free Trade Agreement (FTA). Under the FTA, the EU is committed to the full liberalization of 95% of SA imports over a 10-year transitional period. SA is to liberate 86% of EU imports over a 12-year transitional period.

The African Growth and Opportunity Act (AGOA), which was signed into law by the United States of America, gives South Africa and a number of nations in Sub-Saharan Africa free access to the US market for eight years for an array of products.

The exploratory phases of developing a free trade agreement between South Africa, Brazil and Mercosur is well advanced. Similar arrangements with Nigeria and India are expected to follow.

The Africa-Asia Business Forum contributes to efforts of strengthening economic relations between Africa and Asia, and provides another avenue for further deepening South Africa ties.

South Africa is a member of the Indian Ocean Rim Association for Regional Co-operation (IOR-ARC), a project based regional economic grouping of 15 countries washed by the Indian Ocean. South Africa has established an Indo-South African Commercial Alliance and a Joint Ministerial Commission (JMC) with the Government of India (Appendix 1).

TARIFF STRUCTURE

In 1992, the South African Government instituted a program to drastically reduce tariffs for textiles and apparels over a twelve-year period (Table 3.2). The tariff reduction timetable gives the non-competitive domestic producers a grace period in which to increase efficiency. Textile tariffs will be reduced over twelve years from 100% to 45% on clothing,

from 50% to 25% on fabrics, from 35% to 17.5% on yarn, from 15% to 10% on fibres, and from 60% to 30% on household textiles.

Table 3.2 - South African Customs Union Textiles and Clothing: Tariff

1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Synthetic fibre										
15%	25%	25%	23%	21%	19%	17%	15%	13%	11%	7.5%
Yarn										
35%	32%	32%	30%	28%	26%	24%	22%	29%	18%	15%
Fabric										
50%	45%	45%	42%	39%	36%	33%	30%	27%	24%	22%
Clothing										
100%	90%	90%	84%	78%	72%	66%	60%	54%	47%	40%
Household made-up textiles										
60%	55%	55%	52%	49%	46%	43%	43%	40%	37%	34%

Source: South African Government, Department of Trade and Industry

3.3.2 ECONOMIC FACTORS

This is a major category focuses on the differences on economic characteristics, such as capital, labour, infrastructure and foreign exchange. It provides a general view of the South African's economic development spectrum.

South Africa is a middle-income, developing country with an abundant supply of resources, well-developed financial, legal, communications, energy, and transport sectors, a stock exchange that ranks among the 10 largest in the world, and a modern infrastructure supporting an efficient distribution of goods to major urban centres throughout the region. At the start of 2000, President MBEKI vowed to promote economic growth and foreign investment, and to reduce poverty by relaxing restrictive labour laws, stepping up the pace of privatisation, and cutting unneeded governmental spending.

The current volatility of global financial markets and realignments of emerging market economies has impacted on South Africa heavily, making the government's ambitious reform and restructuring process difficult. The Asian Financial Crisis hit South Africa particularly hard, as Japan and Taiwan are South Africa's two largest trade and investment partners. As a direct result, the South African Rand has lost 25 percent of its value against the dollar since January 1998. South Africa is experiencing an economic slowdown, which began in the 3rd quarter of 1997. During the second quarter of 1998, GDP increased at .03 percent.

The partial privatisation of state assets and the East Asian financial crisis impacted on the value of FDI inflows. Part of the drop in FDI in 2000 can be attributed to the continued political and economic instability in the Southern African region (Figure 3.1). Foreign direct investment flows into SA rose substantially from the first quarter of 2001 to the second quarter.

Figure 3.1 FDI as percentage of GDP

Source from WTO 2001

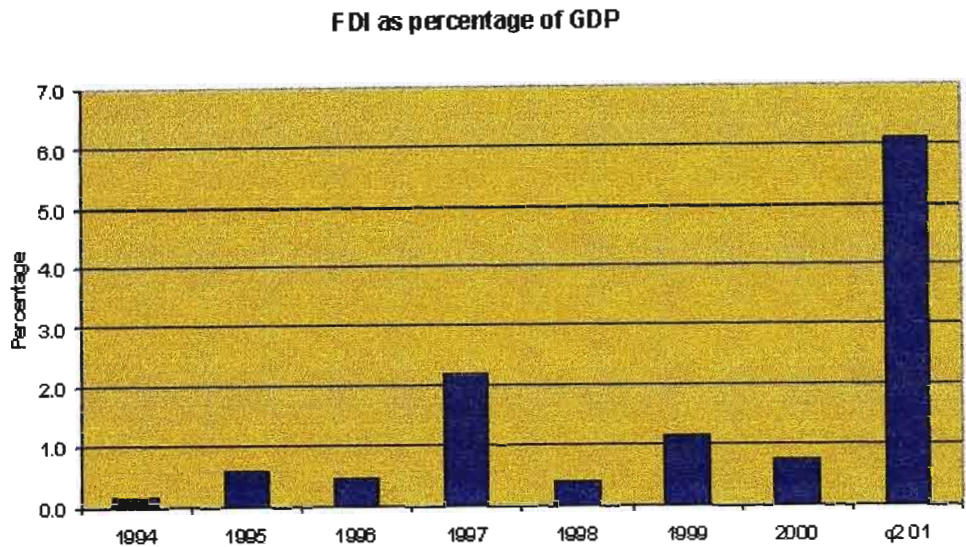
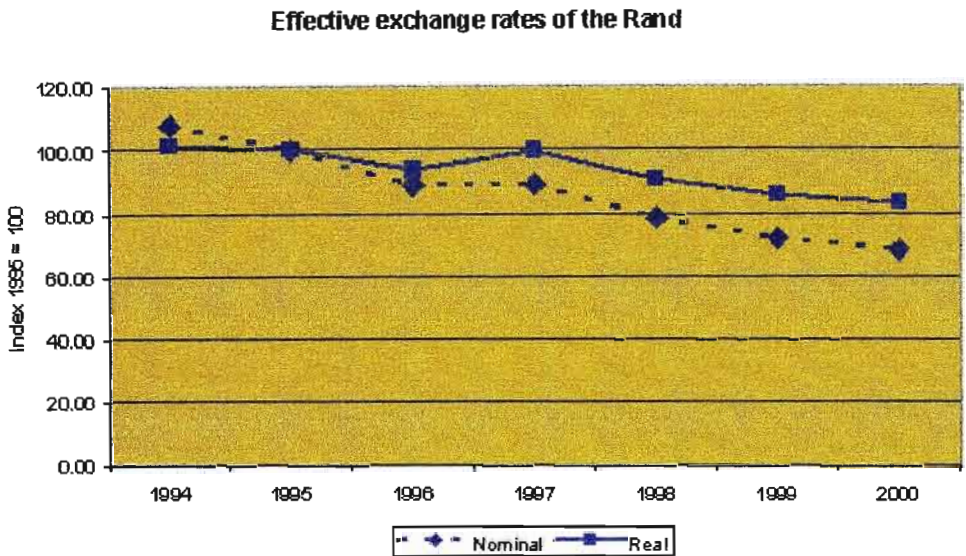


Figure 3.2 – Effective exchange rates of the Rand

Source from WTO 2001



The weighted value of the Rand declined by 8.5 per cent in 1994 and 3.6 per cent in 1995 (Figure 3.2). The sharp decline in the value of the Rand since mid-February 1996 has caught most of the importers by surprise and nullified most forecasts of the exchange rate.

The devaluation of the Rand, from 3.65/USD in 1995 to 6.5/USD in September 1998, and to 11.2/USD in Dec 2001. The continuing weakness of the Rand inhibits foreign companies import from placing orders from their home country. The total textile industry will then be suffered from business lost to duty-free imports due to the various rebate facilities, fraudulent imports and possible increase imports due to the general reduction in customs duties.

The nominal effective exchange rate declined by 18 per cent from the end of 1997 to the end of 1998 due to the emerging market currency crisis in 1998. After the round of speculative attacks in 1998 stability returned to the currency market in 1999 when the Rand strengthened, on balance, by about 15 per cent in 1999.

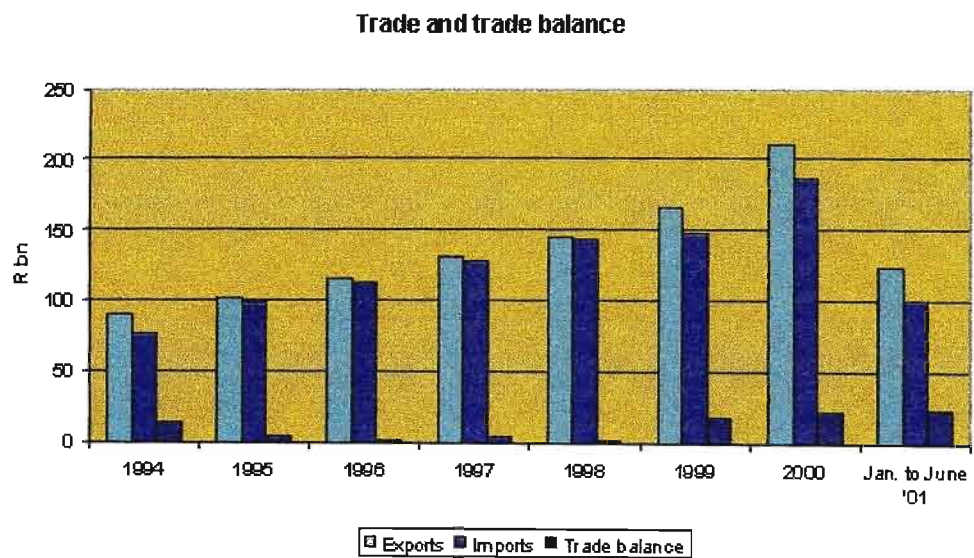
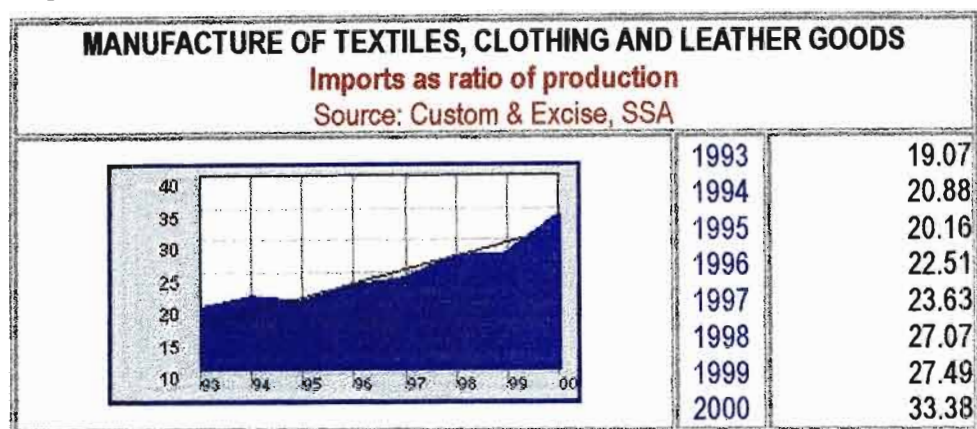


Figure 3.3 Trade and trade balance 1994 – 2001
Source from WTO 2001

South Africa's trade from 1994 to 2000 showed good growth in nominal terms (Figure 3.3). The biggest increase in exports was between 1999 and 2000 (27%). The average growth in nominal exports from 1995 to 2000 was 15.3 per cent. Average nominal import growth was 16.4 per cent over the same period. South Africa also posted a trade surplus since 1994.

Growth in exports in real terms declined marginally only between 1997 and 1998. Negative real export growth of 6.7 % was only experienced between 1998 and 1999.

Figure 3.4 IMPORTS AS RATIO OF PRODUCTION

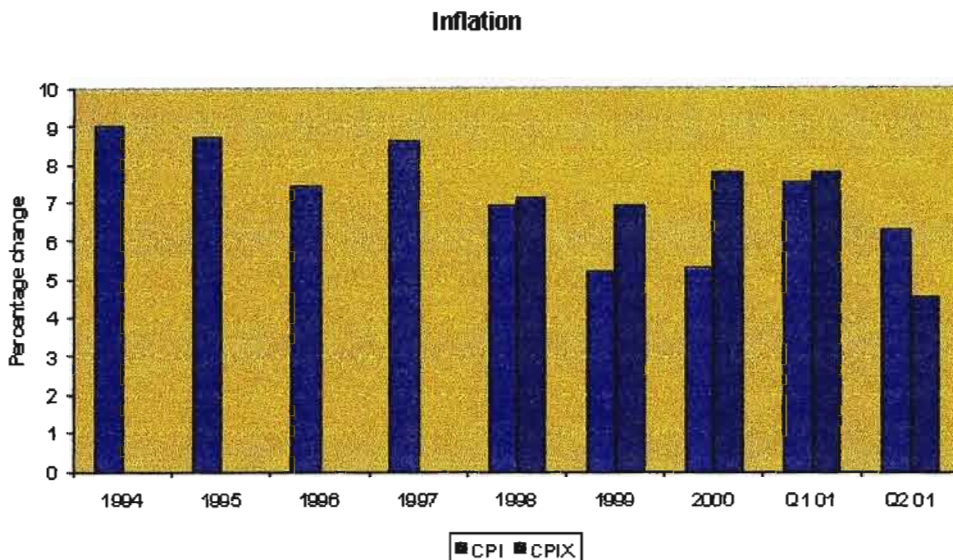


On the import side, figure 3.4 show manufacturing of textile, clothing and leather goods are continuously growth. From 19.07% in 1993 to 33.38% in 2000, it had almost 57% growth on their production during these seven years period.

INFLATION

A consistent counter-inflation monetary policy started to pay dividends in the second half of 1995; when the rates of increase in both production and consumer prices began to subside. The slowdown of inflation in the second half of 1995 was assisted by lower increases and at times even decreases in food prices. The consumer price index (CPI), as measured by year-to-year changes in the overall CPI, decreased from 8,7 percent in 1995 to 7,4 per cent in 1996. The long-term downward trend in inflation continued when average consumer price inflation declined from 8,6 percent in 1997 to 6,9 percent in 1998. Inflation in the prices of consumer goods and services declined from 6,9 percent in 1998 to 5,2 percent in 1999. Overall consumer price inflation, rose quite steeply from 1,7 per cent in October 1999 to 7,8 per cent in February 2000, but then fell back to 6,3 per cent in June 2001 (Figure 3.5).

Figure 3.5 – Inflation
Source from WTO 2001



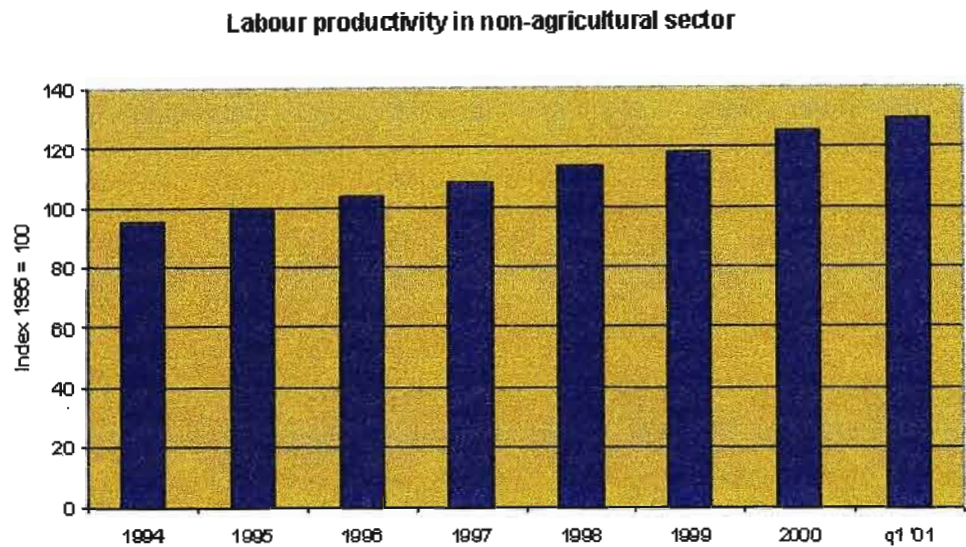
CPIX (overall consumer price inflation for metropolitan and other urban areas, excluding interest rates on mortgage bonds) is the inflation rate used for inflation-targeting purposes. CPIX decreased from 7,3 percent in March 1999 to 6,5 percent in October. Year-on-year CPIX inflation declined from 8.2 percent in August 2000 to 6.4 percent in June 2001. CPIX for June is only 0.4 percent above the upper limit of the inflation target range of between 3 and 6 percent set for 2002.

LABOUR RELATIONS

According to the South African Reserve Bank (SARB), labour productivity is in 6.2% in 2000, (Figure 3.6) compared to the same period in 1999. The SARB states that there was a definite slowdown in the growth of labour costs in the private sector over the past year. Nominal wage growth declined from 8.3% in 1999 to 6.1% in 2000. The average rate of wage settlements in collective bargaining agreements declined from 8.3% in the first quarter of 2000 to 6.8% in the same quarter in 2001. Nominal wage growth in the private sector amounted to 8.5% in 2000, the lowest rate of increase in the past 30 years.

Figure 3.6 – Labour productivity in non-Agricultural Sector

Source from WTO 2001

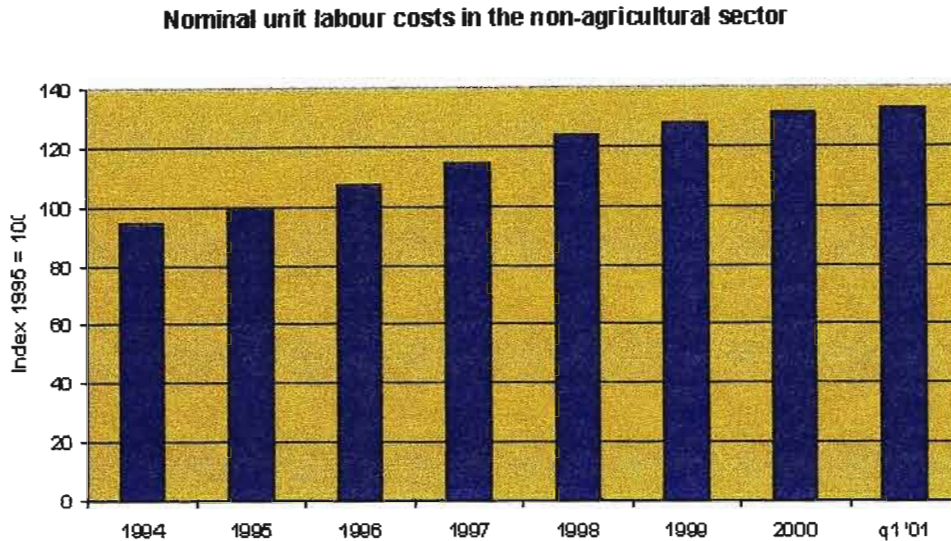


The Labour Act of 1998 promulgates that the minimum wage law applies uniformly throughout South Africa. Minimum wages for unskilled workers range from R150 to R250 per week within major urban areas.

Average wages are as follows:

- Unskilled ± R170.00 per week
- Semi Skilled ± R250.00 per week
- Skilled ± R420.00 per week

Figure 3.7 – Nominal unit costs in the non-agricultural sector
Source from WTO 2001



The slowdown in the rate of increase in the nominal remuneration per worker and the relatively rapid growth in labour productivity led to a decline in the increase in nominal unit labour costs. The slowdown in the rate of increase in the nominal remuneration per worker and the relatively rapid growth in labour productivity led to a decline in the increase in nominal unit labour costs. Due to the strong growth in labour productivity, the year-to-year rate of change in nominal unit labour costs in the formal non-agricultural sector decreased from 9,1 per cent in 1996 to 6,8 per cent in 1997. The slowdown in average remuneration per worker led to lower growth in nominal unit labour costs from 6,3 per cent in 1997 to 6,0 per cent in the twelve months to March 1999. As a result of robust growth in labour productivity, growth in non-agricultural nominal unit labour cost was at a historically low rate of only 2,6 per cent in 2000.

LABOUR LEGISLATION

South Africa has a comprehensive legislative framework, which broadly enables promotion of sound and stable relations at the workforce, and protects the rights of workers and employers, big and small.

Herewith the summary of key legislation affecting labour: -

1. **Basic Conditions of Employment Act:** this Act sets a minimum floor of employment standards while also enabling conditions to be varied through collective bargaining, sectoral determinations, individual contracts of employment and through determinations made by the Minister of Labour.
2. **Labour Relations Act:** aimed at delivering a stable labour relations system, the Act has enhanced organizational rights for trade unions, entrenched the constitutional right to strike, simplified dispute resolution procedures, promoted sectoral collective bargaining and codified dismissal procedures.
3. **Employment Equity Act:** This Act seeks to eliminate unfair discrimination in employment and provides for affirmative action measures to correct the imbalances of the past with respect to access to employment, training, promotion and equitable remuneration – especially for black people, women and people with disabilities.

TRADE UNIONS

There is an active trade union movement in South Africa with three major federations, viz. COSATU, NACTU and FEDHUSA.

TERMINATION OF EMPLOYMENT

Employers may staff at will but cognisance must be given to the provisions of the Employment Act. The Labour Relations Act provides procedures for dismissals, to ensure that all dismissals are fair. There are very few closed shop agreements in operation at present. Most of those that do exist are no longer adhered to as current labour legislation has declared that a closed shop agreement is an unfair labour practice. Employers and employees wishing to terminate employment must give notice of their intention to do so. The period of notice is prescribed in labour legislation for each industry. On termination of employment the employees are entitled to be paid out in lieu of leave accrued but not taken.

PROVINCAL ECONOMY

Economic activities in KwaZulu-Natal are mainly centred in the Durban-Pinetown/eThekweni metropole and Pietermaritzburg, with significant contributions in the Richards Bay/Empangeni area, the Ladysmith/Ezakheni area, the Newcastle/Madadeni regions as well as the KwaZulu-Natal South Coast regions.

KwaZulu-Natal is claimed to have 'the fastest growing, most diversified and outward orientated provincial economy in South Africa', boasting the highest export propensity and the highest level of industrialization in the country. KwaZulu-Natal is second only to the province of Gauteng in terms of its percentage contribution to South Africa's gross domestic product (GDP).

Based on contribution to national production, the most important economic sectors in KwaZulu-Natal are transport (including communication), manufacturing and agriculture. The majority of other sectors make substantial (and in most cases above average) contributions to production in South Africa. The continued strength and growth in KwaZulu-Natal's manufacturing sector are of significance, especially viewed in the textile manufacturing in Newcastle. It has become the national textile capital with 65 percent of all South Africa's textile manufacturing is headquartered in the surrounding industrial areas, including the largest producer of school wear in the country.

PHYSICAL INFRASTRUCTURE

KwaZulu-Natal's strengths are greatly enhanced by the vital attraction of cheaper transport costs, with a comprehensive and cost-effective transport network in place. The sophisticated infrastructure includes the two major ports at Durban and Richards Bay as well as an international airport and excellent networks of railways and major roads.

Durban is strategically situated on major shipping routes, serving as ideal gateways to domestic and international markets. Providing important backward and forward linkages to southern Africa and the Indian Ocean rim, the port of Durban offer excellent opportunities for the other provinces of the country to increase export and import processing.

RAIL NETWORK

The rail network in South Africa falls under the control of Spoornet and the South African Rail Commuter Corporation. Spoornet provides extensive rail transport mainly for goods and containers, as well as transport for passengers travelling long distances between major cities. Metrorail provides commuter rail services on an urban rail network basis that feeds into the major metropolitan cities in South Africa.

The province's well-developed rail infrastructure forms a sizeable part of the national network, with Spoornet providing a total logistical service to business. Along with other carriers, Spoornet plays a dominant role in sourcing traffic in and out of the Port of Durban, utilizing some 2000 kilometres of railway line and running numerous daily trains on the main line between Durban and Gauteng.

ROAD LINKS

KwaZulu-Natal's primary road network is approximately 39 400 kilometres in extent, linking main centres. National and provincial roads are peripheral to rural areas, with toll systems in place on modern freeways. Several business corridor developments are planned for various areas to allow companies to cover distribution routes with a minimum of delay.

WATER SUPPLY

KwaZulu-Natal has sufficient water to meet all its needs. The province also offers industrialists one of the lowest industrial electricity tariffs in the world.

KwaZulu-Natal's river systems are an integral part of the national water macro strategy, with the building of new dam sites providing vast employment opportunities. The success of irrigation schemes along the cane growing coastal belt has had a positive impact on industrial and commercial businesses, while the Thukela basin, with its abundance of quality water, has emerged as a focal point for manufacturing, agricultural and tourism concerns. There is also abundant bulk water in the Mooi River area with its multiple river systems.

ELECTRICITY

The Southern African Power Pool was formed with the objective of establishing a regional electrical network through which electricity is traded in an economical and reliable manner. In the import and export of electricity, utilities in southern Africa boast more than four decades of experience, with numerous bilateral bulk supply agreements existing between countries. Due to the diversity of generation resources, the region has the potential to develop a large and efficient electrical energy market.

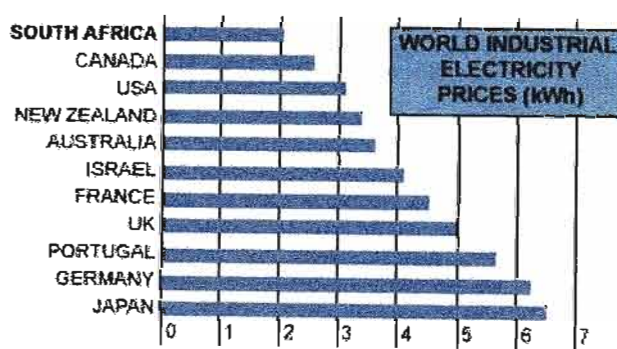
The rates basically consist of three charges:

1. Monthly charge: Ranging from R30 – R 150
2. KVA Charge: Ranging from R 25 – R 40 per KVA per month
3. KWH Charge: Ranging from 6c – 30c per KWH consumed

Every industrial area has a different formula for calculating their client's electricity charge, with the power factor KV/KVA being an additional component of the calculation. Connection fees to different factories / areas are a charge that may also vary considerably.

It is therefore important that a prospective industrialist supply their power consumption details to each Municipality for an estimate of prospective electricity charges (inclusive of any discounts or rebates for new buildings).

The province also offers industrialists one of the lowest industrial electricity tariffs in the world (Figure 3.8) The province has a large labour force offering a well-balanced mixture of skills and low levels of man days lost to strikes.



Source: Electricity Association Services Ltd. Dec. 1986

Figure 3.8 World Industrial Electricity

SERVICES TO COMPANIES

Industrelek assists business concerns in the region to utilize their energy sources as efficiently as possible, with a test and demonstration centre offering specialist advisory services to the commercial, industrial and agricultural markets. Teams of consultants that are technically qualified and experienced in energy efficiency and electrical processes visit business concerns from all economic sectors to give advice or assist with energy-related concerns, making recommendations based on energy usage analysis.

COMMUNICATION

The country's technological infrastructure is becoming a major asset in ensuring its future competitiveness. As the leading economy on the continent, South Africa has a modern telecommunications infrastructure, with a network that is of a standard unsurpassed elsewhere on the African continent and possessing the highest capacity. Innovative in its use of technology, South Africa ranks 23rd in telecommunications development and 17th in Internet use in the world.

As the most significant implementing agent in the telecommunications sector, the national telephone utility, Telkom, has established Vision 20000, a five-year expansion and modernization programme to boost telecommunications access and resulting in a fully digital, world-class network. Through this programme, three to four million new lines are being added to the network, with replacement of existing lines that use obsolete equipment.

3.3.3 SOCIAL-CULTURAL

According to the SA Institute of Race Relations, the average mid 2001 population estimate for South Africa is 44,44 million with 54% of the population is urbanized. The estimated annual population growth rate is 2,2 percent. The potential-laden emerging consumer market in South Africa is young, with increasing purchasing power and a high propensity to consume.

Religions:	Christian 68% (includes most whites and Colour's, about 60% of blacks and about 40% of Indians), Muslim 2%, Hindu 1.5% (60% of Indians), indigenous beliefs and animist 28.5%
Languages:	11 official languages, including Afrikaans, English, Ndebele, Pedi, Sotho, Swazi, Tsonga, Tswana, Venda, Xhosa, Zulu
HIV/AIDS - adult prevalence rate:	19.94% (1999 est.)
HIV/AIDS - people living with HIV/AIDS:	4.2 million (1999 est.)
Labour force:	17 million economically active (2000)
Labour force - by occupation:	Agriculture 30%, industry 25%, services 45% (1999 est.)
Unemployment rate:	20.7% (1996), 30% (2000 est.) (see table 3.4)
Life expectancy at birth:	Total population: 48.09 years male: 47.64 years female: 48.56 years (2001 est.)
Legal system:	Based on Roman-Dutch law and English common law; accepts compulsory ICJ jurisdiction, with reservations
Ethnic groups:	Black 75.2%, white 13.6%, Colour 8.6%, Indian 2.6%
Infant mortality rate:	60.33 deaths/1,000 live births (2001 est.)
Total fertility rate:	2.43 children born/woman (2001 est.)

Fertility rates appear to have been declining for some years now, leading to a declining population growth rate. The increasing prevalence of HIV/AIDS is contributing to a faster

slowdown in this growth rate. It is estimated that from a 2,6% growth rate in 1995, the population growth rate declined to 1,6% in 2000. Population growth is projected to reach zero by 2008.

Table 3.3 Literacy rate

	Black		White		Coloured		Asian		Total	
	Illiterate	Literate	Illiterate	Literate	Illiterate	Literate	Illiterate	Literate	Illiterate	Literate
KwaZulu-Natal	1,613,144	2,272,697	12,136	461,936	9,776	64,038	73,744	457,306	1,708,800	3,255,977

Table 3.4 Economically Active Population Aged 15 - 65 Years by Population Group (%)

KwaZulu-Natal	African / Black	Coloured	Indian / Asian	White	Unspecified / Other	Total
Employed	26.2%	50.2%	50.3%	65.8	27.8	32.2%
Unemployed	24.3%	14.7%	7.4%	3.3	18.8	20.7%
Not economically active	49.4%	35.1%	42.2%	30.9	53.4	47.0%
Total	100.0%	100.0%	100.0%	100.0	100.0	100.0%

Source: StatsSA (Census 1996)

Table 3.5 Skills Structure

KwaZulu Natal	
Legislators, senior officials and managers	49,07
Professionals	144,273
Technicians and associate professionals	89,79
Clerks	109,067
Service workers, shop and market sales workers	126,425
Skilled agricultural and fishery workers	51,69
Craft and related trades workers	186,319
Plant and machine operators and assemblers	118,776
Elementary occupations	377,072
Unspecified/Other	318,073

Source: WEFA, Regional Economic Focus, 1999

The adult literacy rate for KwaZulu-Natal stands at just over 80 percent, which functional literacy over 90 percent (Table 3.3). The proportion of the population in possession of a senior certificate or better is about 23 percent (Table 3.5). Supportive measures are being taken to assist in the development of economic literacy among the unemployed and the youth of the province.

CHANGING CONSUMPTION TRENDS

South African consumers are changing their consumption patterns. Over the longer term, the services component of household consumption has been the fastest growing of the four, with durable consumption having been the slowest. The reason for the shift towards services is probably based to a certain extent on increasing specialization of functions in a modern economy. It is an economy in which households prefer to utilize services as opposed to performing tasks themselves. A further reason is the perceived poor quality of certain government services, driving a greater demand for security services, medical and education services. Finally, certain services that are relatively new to South Africa, such as gambling and cellular phones have experienced dramatic growth in demand.

The poor performance of durable goods consumption may have much to do with high real interest rates. These imply high financing costs for products such as motor vehicles, for which few consumers can afford to pay cash. Non-durable household consumption, for example food, is more strongly linked to population growth. Given that population growth rates are declining, it is not surprising that this component is expected to experience a mediocre performance. Beverages and tobacco are furthermore experiencing substantial cost-increases as a result of hikes in “sin taxes”, while also possibly suffering from being a potential substitute for gambling. Consumption of semi-durable goods, dominated by the clothing and footwear component, appears to be experiencing sound growth, with rates not far behind services demand.

CULTURAL

The most famous study of how culture relates to values in the country was undertaken by Geert Hofstede (1991). Hofstede defines culture as the “software of the mind” that guides us in our daily interactions. “Culture is always a collective phenomenon, because it is at least partly shared with people who live or lived within the same social environment, which is where it was learned. It is the collective programming of the mind which distinguishes the members of one group or category of people from another” (Hofstede, 1991:55).

Hofstede’s model isolated four dimensions that he claimed summarized different cultures – power distance, uncertainty avoidance, and individualism versus collectivism and masculinity versus femininity.

According to Hofstede (1991), South African is in high- power distance countries, subordinates tend to be afraid of their bosses, and bosses tend to be paternalistic and autocratic. People in the management level are tend to be more on the individualism and are expected to look out for themselves. However, the unskilled and semi-skilled labours are more collectivism with strong family and group relations. In the feminine S.A countries, conflicts can be resolved by negotiation. A high rate of avoidance of insecurity was found in low-skilled labours. The need for personal development is low, average age is high in important positions for decision-making, rules should not be exceed, risks should be avoided and individual competition is disliked. When the future is unpredictable people become nervous, worried about the future, considered not capable of taking initiatives or have ambitions.

3.3.4 TECHNOLOGY

Technological change is one of the most important sources of change in the economy; it alters the mix of products, industries, businesses and work. The technology capacity in South Africa has not been adequately translated into dynamic textile and clothing industry. The level of business creation is low, especially in small factories. The main reason being is due to a lack of entrepreneurial behaviour of the most South African people. The economy remains largely dependent on natural resources, primary processing and manufacturing and, for the most part, on imported technologies.

3.4 UNDERSTANDING INDUSTRY STRUCTURE

“Every enterprise needs a concept of its industry... different concepts among the enterprises involved are likely to express competitive forces in their most vigorous and most decisive form.”

Alfred P. Sloan, JR. General Motors

The South Africa’s economic, political, cultural and demographic characteristics tend to give a special shape to the competitive environment at the industry level. The immediate competitive environment for a firm is its industry; therefore the third component of our Environmental Analysis Framework (EAF) aims to understand the distinctive nature of industry structure.

The rate of return on invested capital (ROI) in an industry, relative to the industry’s cost of capital, is determined by five sources of competitive pressure, which impinge upon the firms within the industry. The Porter “Five Forces” model is largely based on analysis markets, industries and experience, which we have illustrated the framework in chapter 2.

In South Africa, government’s influence is so pervasive and powerful over the textile and clothing industry structure. It can constitute to be a sixth competitive force which joining Porter’s five. Government is the gatekeeper determining who has access to key resources; it is the controller determining the prices and costs. Its actions do not affect all actors or other competitive forces in the industry uniformly. By themselves, its actions can create competitive advantage, or, more important, companies within an industry can create competitive advantage by the nature of their response to government actions.

Government as shaper of the competitive environment

One of the significant features of South Africa is the relatively greater role that governments play in the economy. Their actions often substitute for and change the dynamics of the market forces in an industry. Consequently, the competitive environment can be drastically altered.

3.4.1 INTENSITY OF RIVALRY

Because the government is the gatekeeper to many critical resources such as foreign exchange, tariff, and import licenses, one of the key forms of competition within the textile and clothing industry is SAG frequently have sectoral policies that significantly influence the growth rates of the textile industries. Expansive policies will tend to reduce rivalry, for firms do not have to fight each other for market share to grow.

Among the major factors determining the nature and intensity of competition between established firms are:

- Concentration
- Diversity of competitors
- Product differentiation

Concentration

Seller concentration refers to the number of competitors in an industry and their relative sizes. Seller concentration is most commonly measured by the concentration ratio, which is the combined market share of the leading producers. 65 percent of South Africa's textile manufacturing is headquartered in Newcastle (Kwazulu Natal). It has become the national textile capital. Since 01/01/1982 to 31/12/2000, 77 industrial stands totally 72,7186 hectares have been sold at selling price of ZAR 3096,841.00 to prospective industrialists.

Diversity of Competitors

The ability of the firms in an industry to avoid competition depends not only upon the number of firms, but also on their similarities in terms of origins, objectives, costs, and strategies. More than 80 Chinese entrepreneurs from Taiwan, China and Hong Kong have established undertakings in Newcastle, employing 8000 people in the manufacture of products. In year 2000, there were 15 factories opened and created 2002 job opportunities. Majority of these factories are manufacturing clothing, footwear and shoes. The size of the factories are small / medium level, they are either family business or state-own enterprise from China.

One of the largest local textile manufacturer is the Frame Group, which have employing 5700 employees with an annual turnover in excess of USD 200 million. They are a world-class producer of yarn, woven, non-woven, and knitted fabric, made up home textiles and industry related chemicals.

Product Differentiation

The more similar are the offerings of rival firms, the more willing are customers to substitute between them, and the greater is the incentive for firms to cut prices in order to expand business. Large amounts of the FDI manufacturing industries are taking advantage on the SAG's SMMDP, their productions are either sell it locally or exporting to USA. The products requirements are very similar according to the US's free quotas standard.

3.4.2 BARRIERS TO ENTRY

Government affects competitive dynamics by influencing the entry of potential competitors through tariff barrier. SAG seems intent on conforming to the standards of the WTO, the legacy of an import substitution policy supported by high tariffs and import permits has left the South African apparel industry largely non-competitive on the world market. The final and capital goods are threatening the successful attainment of the inflation target ranges set for 2002 and 2003. The uncertainty created by volatile Rand movements is also likely to make international investors nervous and increasingly reluctant to commit investment funds to this economy.

Economies of Scale

In the manufacturing sector with capital intensive, efficiency requires producing at a very large scale. New entrants are faced with the choice of entering either on a small scale of drastic under utilization of capacity while they build up sales volume.

Capital Requirements

The capital costs of getting established in the textile industry in SA can be so large as to discourage all but the largest foreign companies. Generally, sunk costs exist where entry requires investment in industry-specific assets, which cannot be recovered on exit.

Access to Channels of Distribution

Limited capacity within distribution channels, risk aversion, and the fixed costs associated with carrying an additional product result in distributors' reluctance to carry a new manufacturer's product.

Distribution channels are the traditional weak point of the foreign firms. No matter how strong the company's product or how attractively priced, it will not succeed unless it has access to distribution services able to get it to prospective purchasers at the time and in the condition required. The problem for the newcomer is first of all identifying the particular channel structure.

3.4.3 BUYER POWER

The textile and clothing industry operate in two types of market: The markets for inputs and the market for outputs. In the markets for inputs they purchase raw materials, components, finance, and labour services from the suppliers of these factors of production; in the markets for outputs they sell their products and services to customers, who may be distributors, consumers or other manufacturers. In both these markets the relative profitability of the two parties to a transaction depends upon relative economic power.

Due to the competitions are so intense, and the production are normally similar to the competitors. Therefore, buyers tend to be high price sensitivity, especially for the productions for export. Basically, it is a cutthroat business, product price need to be attractive in order to achieve the economies of scale.

3.4.4 SUPPLIER POWER

Analysis of the determinants of relative power between the producers in an industry and their suppliers is precisely analogous to the analysis of the relationship between producers and their buyers. Since the factors which determine the effectiveness of supplier power against the buying power of the industry are the same as those which determine the power of the industry that of its customers, they do not require a separate analysis.

However, governments can influence access to supplies and the most common policy instrument affecting supply access is import controls. These could be direct tariffs or indirect (foreign-exchange allocations for imports). The more restriction the import controls, the greater bargaining power local suppliers have, because the purchasers' supplier alternatives are reduced.

3.5 PORTER'S DIAMOND – CHINA

In chapter 2, the diamond framework have been outlined to illustrate the factors, which influence the competitive advantage of industries. What factors are likely to give the textile and clothing of China a competitive advantage in the international markets? In attempting to provide an answer, the diamond framework will be applied to analyse the determinants. A brief account is given of the evolution of the textile and clothing industries in China from the 1950s.

Communist China emphasized the development of heavy, rather than light, industry in the early 50s. Textile's share of gross industrial output fell from 25 per cent in the early 1950s to 15 percent in 1984, although in absolute terms output continued to rise. Larger factories were under the direct control of the ministry of textiles, but many smaller units were operated by collectives and States Own Enterprises (SOEs). Shanghai and the coastal regions dominated the modern sector of the textile industry in the 1940s. But it was the policy of the communist government to increase regional self-sufficiency in every industry, and new textile plants were opened in the inland provinces. The Great Leap Forward and the Cultural Revolution disrupted the development of the Chinese economy. Textiles suffered along side other industries during these upheavals, but the overall trend was one of steady technical progress.

Between 1955 and 1981, total factor productivity in Chinese textiles rose by 95.4 per cent, which was better than the improvements in coal mining and machine-making (Tidrick 1986:12). After 1978 the regime introduced a number of economic reforms. Instead of supplying all of their output to state distribution authorities, firms were allowed to dispose of a proportion of their production as they saw fit. More leeway was given to factories to pay incentive bonuses, and a share of the profits could be retained for the unit's own use. Permission was given for the instigation of new textile and clothing enterprises, some of which were run by village communities and others by private entrepreneurs.

Over the past 25 years, China has re-emerged as one of the most powerful and influential nations on earth. This was the result mainly of the fundamental economic reforms instituted in China and far-reaching effect China economic renaissance has had on the global economy. China is expected to be world largest economy by GDP early into this century; China has increasingly been asserting an international role for herself. Strengthened by her position as a Permanent Member of the UNSC, and her increasingly hegemonic position in the Asian region, indications are that, while still a developing country, China envisages a position for herself among the leading nations of the world.

Table 3.6 Share of textiles in trade in total merchandise and in manufactures by region, 2000

	(Percentage) Exports	Imports
Share of textiles in total merchandise		
World	2.5	2.5
North America	1.2	1.5
Latin Amercia	1.4	3.3
Western Europe	2.4	2.2
C./E. Europe/Baltic States/ CIS	1.9	4.4
Africa	0.9	5.5
Middle East	0.8	4.3
Asia	4.3	3.4
Australia, Japan and New Zealand	1.4	1.3
Other Asia	5.8	4.1
Share of textiles in manufactures		
World	3.4	3.4
North America	1.6	1.8
Latin Amercia	2.3	4.3
Western Suope	3	2.9
C./E. Europe/Baltic States/ CIS	3.4	6.2
Africa	3.6	8
Middle East	3.5	5.8
Asia	5.1	4.8
Australia, Japan and New Zealand	1.6	2.6
Other Asia	6.9	5.6

SOURCE: WTO 2001

During the last decade, output from China has been expanding by an average of 10 per cent a year, while merchandise export volume has been growing even faster, at about 15 per cent. In two decades, the value of China's merchandise export has expanded more than twenty-fold, reaching US\$ 151 billion last year. China is already the world's fifth largest trading power, and the second largest recipient of foreign investment. Today the Chinese economy represents between 5 to 10 per cent of global output, depending on the method used to calculate national production.

The Evolution of competitive advantage

China's accession to the World Trade Organization (WTO) in Dec 2000. This recent reform allow liberalization of trade and investment as a result of the accession notably relaxation of the restrictions on foreign participation in joint ventures and equal treatment of foreign and national companies. It provides more Foreign Funds Enterprises (FfEs) with greater investment opportunity into China.

The firm owns assets that can be profitably exploited on a comparatively large scale. Assets include: capital, intellectual property, managerial skills and technology. It is more profitable for the production process utilizing these assets to be located in different countries.

3.5.1 FACTOR CONDITIONS

Factor conditions exert a major influence on the growth and survival of the industries. It is understandable that they should occupy a prominent place in the diamond. Textile industries are relatively intensive users of some factors, including standardized labour and management skills. A plentiful labour supply has often been regarded as the critical factor in determining competitive advantage in textile industry.

China has an abundance of labour resources and a relatively low level of wages, and it pays close attention to its citizen's education that has resulted in a highly competent quality workforce. The latest data from UNESCO, 1999 indicated that the number of university graduated in China exceeds a million, compared with about 380,000 for Indonesia and the

Republic of Korea. Moreover, the number of technicians per million habitants is 200, which is less than for the Republic of Korea (318) and Singapore (301), but much more than for India (108), Malaysia 932) and Thailand (30).

The Chinese people have developed a culture based on hard work. It's common practice for them to work extremely long hours and achieve high levels of productivity. It also has a high quality workforce, which can transfer their knowledge skill to S.A.

Chinese economy has the potential for developing self-contained, technology-intensive, large-scale manufactures that combine high quality human capital with low labour and infrastructure costs. It also has the market to support large-scale production.

An average manufacturing wages are lower than those of the industrialized and developing economies listed in table 3.7, but its average manufacturing unit cost is higher than in seven of the developing economies.

Table 3.7 Wages and unit labour cost s in manufacturing: comparison between China and selected developed and developing economies, 1998

Economy	Ratio to Chinese Level of	
	Wages	Unit labour costs
United States	47.8	1.3
Sweden	35.6	1.8
Japan	29.9	1.2
Singapore	23.4	1.3
Taiwan Prov. Of China	20.6	2.3
Republic of Korea	12.9	0.8
Chile	12.5	0.8
Mexico	7.8	0.7
Turkey	7.5	0.9
Malaysia	5.2	1.1
Philippines	4.1	0.7
Bolivia	3.7	0.6
Egypt	2.8	1.5
Kenya	2.6	2.0
Indonesia	2.2	0.9
Zimbabwe	2.2	1.2
India	1.5	1.4

Source UNCTAD – China statistical Yearbook 1999.

3.5.2 DEMAND CONDITIONS

Favourable domestic demand conditions are an important element in the home base of many industries. A secure home base is often the platform from which a successful export campaign is launched. Porter (1991) stresses that the quality of home demand may be more important than its absolute size. Firms are in a better position to monitor and interpret the needs of customers in their home region than they are of the requirements of purchasers in distant places. Information gathered about customer requirements may have a major impact on decisions about the introduction of new products and the styling of existing lines.

China was the dominant fibre consumer in the developing world, reflecting its enormous population and its comparatively high per capita fibre consumption. China ranked second in the world as a final consumer of fibre products. China has a huge domestic market and now become a major leading force in the world textile industry.

Liberalization of clothing imports in China shift domestic demand in favour of high quality clothing, which lead to increased imports of high quality textiles. Growth and demand has reflected strong fixed investment and private consumption. According to WTO, in the first seven months of 2001, fixed investment by state enterprises jumped 18%, mainly due to increased spending on property, technical upgrades and infrastructure development.

China's living standards have doubled in the last decade, and will no doubt double and tripe again. New opportunities are opening up for Chinese workers and Chinese entrepreneurs. New choices are opening up for Chinese consumers.

3.5.3 RELATED AND SUPPORTING INDUSTRIES

No industry is a completely self-contained entity it requires input manufactured by other industries. China has an advanced and sound infrastructure in place. The required importation of 40% of raw materials can easily be transported via sea or air. The many

well-equipped ports will cater for large freight movement from suppliers and to customers. Products can be moved domestically via the extensive road and rail networks.

The sophisticated telecommunications network, would allow for the speedy transfer of information between the home and the host country. The extensive use of Internet facilities coupled with the huge number of televisions, will allow the organization the medium to advertise and to successfully reach its target market.

3.5.4 FIRMS STRATEGY, STRUCTURE, AND RIVALRY

State Owned Enterprises are characterized with excessive employment, high inventory levels, low productivity, low capacity utilization, inefficient scales of production and outdated technology. In spite of some shift in economic activities from the public to the private sector, (Table 3.8) SOEs likely to be worst affected by accession operate in textile industry. The Foreign Fund Enterprises (FFE) mainly from Hong Kong (China) accompanied by the introduction of more recent technologies, more capital-intensive methods of production and higher labour productivity. Therefore the SOEs will not be able to sustain their market share over the long run. Their possible strategies will be moving their labour-intensive processes to poorer countries, investing in more advanced equipment or seeking government aid and protection.

Table 3.8 INDICATORS OF CHINA'S TEXTILES AND CLOTHING, 1999

	Textiles Industry			Clothing Industry		
	All Enterprises	SOEs	FFEs	All enterprises	SOEs	FFEs
Number of enterprises	10981	3011	3032	6611	792	2864
Sales (billion of yuan)	414.8	148.2	88.3	184.7	13.5	90.9
Percentage share on total sales of the industry	100	35.7	21.36	100.	7.3	49.2
Valued added as a percentage of output	24.7	26.9	24.2	24.8	28.4	24.9
Valued added per worker	21900	15300	38500	24500	16800	25800
Profits (billions of yran)	3.9	-0.14	1.29	6.2	0.13	2.64
Profits as a percentage of sales	0.94	-0.09	1.46	3.36	0.96	2.90

Source: National Bureau of Statistics, China Statistical Yearbook 2000.

3.5.5 GOVERNMENT

Firms build and sustain competitive advantage in world markets by establishing a strong home base and by continually improving the quality of their inputs, processes, products and distribution networks. Such upgrading adds greater amounts of value at each stage of the value chain, extending from the provision of inputs to final delivery to the customers. Firms, their suppliers (including workers) and their customers share in the benefits of upgrading. However, in many cases these activities are under the control of the government.

The Chinese's government is encouraging upgrade of the technology. They will implement a strategy called "Winning by Quality, Market Diversification and Re-invigorating Trade by Science and Technology". At the same time, the country will transform the growth mode of foreign trade and economic cooperation, make unremitting efforts to restructure the foreign trade and economic sector, further optimise the import and export product mix, mode of trade and regional and market structures, increase the added value of processing trade, and realize a fundamental transformation In China's foreign economic and trade development, namely from expansion and quantitative growth to growth based on quality and economic efficiency.

Manufacturing textile and clothing industry in China is fit in to the Vernon's product life cycle theory. Vernon's theory is that new products are developed in the most advanced economy. Over a period of time, other countries learn how to make the product. Once knowledge about the product is commonplace, it is cheaper to manufacture it in countries with low wages. Companies from the most advanced country establish subsidiaries abroad to take advantage of these low costs. Therefore, the cyclical pattern plays an important role in this analysis. Flows of technology make a large contribution to the cycles, which affect the textile sector.

3.6 INVESTMENT ADVANTAGES IN SOUTH AFRICA

South Africa's economic and social policies are ensuring the international reintegration of the country's economy and the creation of an environment for sustained export growth, healthy net capital inflows and improved investor confidence. The highly developed economic infrastructure, vast scope, and a huge emergent market economy have given rise to a strong entrepreneurial and dynamic investment environment with many competitive advantages and opportunities.

Initiatives for export-driven manufacturing are able to take advantage of the devaluing currency and the export policy direction of the government. This situation creates an incentive to locate manufacturing plants closer to international transport routes. As a vital center for multi-modal transportation and value-added activities, KwaZulu-Natal is able to assume a role as a continental gateway to Southern Africa. The following factors enhance the province's potential as an ideal investment location:

- An unmatched strategic geographical position provides easy accessibility to local, national and global markets. Placed on the crossroads of east and west, the region has ties with Indian Ocean Rim nations, the best access to the Pacific Rim and links deep into the African continent. As a gateway to all the major markets in South Africa, there is perfect placement for the servicing of industries and consumers in the country's other provinces, as well as being a springboard to the developing markets of sub-Saharan Africa.
- South Africa's agreements on trade, development and cooperation facilitate the expansion of secure markets for business.
- Physical infrastructure is comparable to developed world standards, with an extensive network of railways and roads, as well as the largest capability for handling containerized sea traffic.
- There is an abundance of established intermediate industry inputs and support from downstream industry, with prime sites in industrial parks situated close to transportation routes. Based on consideration of costs, certain selected industrial

undertakings can be operated more profitably if established in KwaZulu-Natal than in other competing investment regions in the world.

- World-class information technology provides access to global telecommunication highways, with high-speed international links and a mobile communications network regarded as one of the best.
- Comparatively low industrial electricity tariffs are available, with the entire province linked to the national power grid.
- There are ample water resources, with huge storage dams supplemented by many natural lakes and water supply of excellent quality available at low cost.
- A comprehensive network of public and private health facilities and hospitals has been established, with highly specialized medical care services available.
- One of the world's most enviable lifestyles may be enjoyed, with a temperate climate, friendly people and an idyllic living environment, as well as access to innumerable sporting, recreational and cultural facility. Fully serviced residential properties may be purchased at a significant discount compared to similar properties in the western world.

KwaZulu-Natal represents a microcosm of the economic and social conditions of South Africa as a whole, with several studies confirming the phenomenal growth trends and high economic potential of this province. The province traditionally attracts more investment in new industrial projects than any other province and has proven to be area in which investors can enjoy higher returns at the faster pace.

As at 11 May 2001, five of the defined forty-eight Sub-Saharan Africa (SSA) countries have been approved by the United States for benefits under AGOA, and are permitted duty-free access for clothing exports into the USA.

The first two countries to be approved were Mauritius and Kenya, followed on 6 March by the approval of South Africa and Madagascar and by Lesotho on 23 April. At present there are 8 other beneficiary SSA countries, where applications for approval under AGOA are pending. The next most likely countries to be approved are Malawi, Botswana and Ethiopia.

At present, AGOA only provides for the duty-free access of clothing under strict rules of origin to the USA. Various categories of duty-free access for clothing articles are provided for. These can be summarized as follows:-

1. Duty-free and quota-free access for clothing manufactured in SSA from fabric wholly formed and cut in the USA from yarns wholly formed in the USA;
2. Duty-free access for clothing manufactured in SSA from fabric manufactured in SSA from yarn originating in the USA or SSA, but subject to a quota equivalent to 1,5% in year 1, rising in year 8 to 3,5% of the value of total clothing imports into the USA;
3. Duty-free access for clothing manufactured in lesser-developed SSA countries, regardless of the origin of the fabric up until September 2004 and subject to the above quota;
4. Duty-free and quota-free access for sweaters of cashmere or of 18,5 micron or finer wool, knit-to-shape in SSA;
5. Duty-free and quota-free access for clothing manufactured from fabric or yarn not available in commercial quantities in the USA; and
6. Duty-free and quota-free access for hand-loomed, hand-made and folklore articles. Certain concessions are provided for in the case of the use of foreign origin interlinings, finishing and trimmings in the manufacture in SSA of clothing as long as the value of these items does not exceed 25% of the value of the clothing article.

Another concession is that non-USA or non-SSA fibre and yarn is permitted in the manufacture of clothing up to 7% by weight of the garment.

The legislative process is currently underway in the USA, whereby proposed additions and amendments to AGOA are being considered: the so-called AGOA II or Bush's African Enterprise Initiative. Aspects that will be important for South Africa and indeed many other SSA countries to have changed would be the extension of AGOA beyond September 2008, the termination on 30 September 2004 and the non-extension to higher developed

SSA countries of the third country fabric concession, the inclusion of yarns, fabrics and household textiles as qualifying for duty-free access and a number of the other existing provisions of AGOA.

It is important that - this time round - industry and government work in concert to achieve these objectives.

Human Resource Development is receiving urgent attention in South Africa. Many policy interventions have been initiated in this field to make South Africa more competitive in the World economy. The Department of Labour has introduced an ambitious programme that seeks to enhance skills development through education and training.

3.7 INVESTMENT DISADVANTAGES IN SOUTH AFRICA

In spite of an improvement in the political and economic environment since 1994, ongoing investor uncertainty regarding the long-term future of the country remains. Some probable reasons for this uncertainty and lack of confidence, and the resultant Rand weakness experienced in the second half of the 1990s, are as follows:

- The poor quality of the labor force due to a highly unequal skills distribution. This has largely been brought about by the past inequalities in education, skewed along racial lines.
- Labor market inflexibility.
- A highly unequal income distribution and high levels of poverty. This situation, if not addressed, has the potential to exert pressure on the government to implement populist policies in future years, abandoning its currently business-friendly policies laid down in the GEAR strategy.
- High levels of corruption, crime and violence, adding to the cost of doing business in South Africa.
- Government's incoherent policy outside of monetary, fiscal and trade policy. Currently, a prominent issue is the slow pace of privatization and deregulation as well as the uncertainty surrounding the future timing of such privatization and deregulation initiatives. The best example is the current uncertainty surrounding the telecommunications sector policy and the listing of Telkom.
- Troublesome neighboring states. Political turmoil in Zimbabwe, and its possible contagion effect on South Africa is one of the current concerns. However, a further problem results from the fact that neighboring states offer very limited markets to South African businesses.
- South Africa's classification as an emerging market has exposed it to additional volatility at times when emerging markets fell from favor, as was the case in 1997/98. Currently, the global slowdown has brought the economic well-being of this group of markets into question.

In Table 3.9 the most significant obstacles identifies by foreign and locally owned firms are shown, it is demonstrated that the locally-owned companies are more concerned than foreign owned companies regarding of South Africa crime and related social problems.

Table 3.9 Most Significant Obstacles identifies by firms

Foreign owned	%	Locally owned	%
Crime and related social problems	42	Crime and related social problems	56
High levels of interest rates	40	High levels of interest rates	51
Labor regulations	35	Labour regulations	41
Poor sales outlook	31	Fluctuations in the interest rate	40
The level of the exchange rate	30	High company tax rates	39
Exchange rate instability	30	Uncertainty over labour relations	39

Source: National Enterprise Survey

3.7 CONCLUSION

This chapter completes the elaboration of the environmental analysis framework. The first component of the EAF is the categorization of environmental phenomena into economic, political, cultural, demographic and technology factors. These four interrelated groups allow the MNC to scan and analysis their business environment more systematically and with a sharper focus. The second component of the EAF enables the MNC to analyse the five forces in the textile and clothing industry in South Africa. The third component of the EAF, through the Porter's diamond to identify the distinctive nature of the key success factors in China.

The globalisation of the South Africa 's economy offers a wide range of opportunities, well-developed infrastructure, excellent communication and transport links, lower labor costs compared to industrialized countries, and inexpensive electrical power. South Africa actively encourages direct and indirect investment by non-resident persons and companies. Virtually all business activities are open to foreign investors and there are generally no restrictions on foreign investment. However, it also exposes numerous challenges, the country continues to face with shortage of skilled labor, particularly in professional fields, The skills shortfall is the result of shortcomings in the educational system and departures of skilled labor from South Africa. Companies have little power to lay off workers as well as finding appropriate black staff to fill quotas set by the employment equity legislation. Furthermore, high AIDS infection levels pose further problems, high levels of crime, fluctuating currencies, nepotism, corruption, and multiple layers of obstructive bureaucracy all frustrate businesses in South Africa.

Barriers to entry for new firms and exporters are low, and consequently the degrees of international competitions are intense. Competitive advantage is very difficult to sustain for long periods of time due to the product similarity. A nation's factor endowments exert a strong influence over its competitive advantage in the production of goods and services.

By applying the EAF, MNC can systematically examine environmental characteristics, country strategies and industry structure and dynamics so as to formulate more effective company strategies.

CHAPTER 4
STRATEGY EVALUATION
AND
SELECTION

Chance favours the prepared mind

Louis Pasteur

Fit between a parent and its businesses are a two-edged sword:
a good fit can create value: a bad one can destroy it.

Andrew Campbell

4.1 INTRODUCTION

This chapter describes the multifaceted task of matching strategy to a firm's external and internal situations by considering the textile and clothing industry and its Macro-environments. It is important to be sure that the customized aspects of the proposed strategy are well matched to the firm's competencies and competitive capabilities and the strategy addresses all strategic issues the firm confronts.

An evaluation will be presented of the attractiveness of the South Africa's manufacturing textile and clothing industry. Then an examination will be made of the options of entry mode strategies and the third part will deal with the assessment of competitive strength and performance potential of its business, and deciding on what strategic actions to take.

The ultimate commitment is to develop a foreign manufacturing subsidiary to service the host country markets. Therefore, poor choices of strategic direction are costly. How can the likelihood of bad decisions be reduced, and decisions be encouraged? This chapter proposes a series of challenging test questions that are critical to any strategy review.

Each of the test question formulated is posed as a measure of the credibility of a proposed strategy; the answers determine whether the MNC has confidence that the promised returns on the investment will be realized.

Assessments of market attractiveness must consider events and trends in the macroeconomic and industry environment as well as conditions within the segments of the market the strategy proposes to target.

How attractive is the market opportunity?

Market attractiveness analysis should present a balanced view – the threats versus the opportunities uncovered during the situation assessment. Included here is the anticipated impact of events and trends in the aptly named PEST environment (the political, economic, social, and technological forces covered in Chapter 3). Supplementing these factors are the

specific attributes of the competitive market to be served (Table 4.1).

Table 4.1 Attractiveness of the manufacturing textile and clothing industry.

Criteria	
Size	Small / Medium
Growth	Moderate
Cyclically	Low
Intensity of competition	High
Access of channels	Easy
Break-even share	Moderate
Costs to serve	Moderate
Overall attractiveness	+++

The overall attractiveness of doing business in South Africa's manufacturing textile and clothing industry depends on balancing the likely long term benefits of doing business in the country against the likely costs and risks.

A principal consideration in evaluating a diversified company's business makeup and the calibre of its strategy is the attractiveness of the industries it has diversified into. The better the market opportunity measures up on these criteria, the higher the long-run average profitability of the FDI companies in the market.

4.2 STRATEGY OPTIONS

An understanding of strategy and of an organization's external and internal environment in and of itself does not generate strategy. MNC need to transform knowledge about the industry, about the environment outside the industry, and about their own organization's resources and competencies into opportunities. Thus companies should develop a range of strategy alternatives.

The optimal entry mode for these foreign companies from China depends to some degree on the nature of their core competencies. Chinese companies willing to expand internationally to earn greater returns from their core competencies, transferring the skills

and products derived from their core competencies to foreign South African markets where indigenous competitors lack those skills.

As the preceding discussion demonstrated, there are advantages and disadvantages associated with all the entry modes as summarized in Table 2.9. Choosing the right mode of entry is a complex decision because of the multitude of relevant variables. According to the Business Map categories of firm intentions (Table 4.2), new investments, expansions in productive capacity, mergers and acquisitions, failed investments; liquidations and disinvestments, mergers and acquisitions increasingly dominate investment types. This trend differs from the Southern Africa region, which is dominated by new ventures and suggests that the South African economy offers a greater set of opportunities for joint ventures than its neighbours.

Table 4.2 Kind of investment by percentage

KIND	% (1994-99)
MERGERS & ACQUISITIONS	60.4
EXPANSION	17.3
NEW	16.7
INVESTMENT	4.5
INTENTION	3.1
LIQUIDATION	(-) 0.6
DISINVESTMENT	(-) 1.5

(Source: Business Map's on-line SA FDI database)

Analysis of the choice of entry mode has traditionally focused on financial, managerial, and legal issues. The height of entry barriers is an additional issue that both affects the traditional ones and has an impact of its own.

Licensing and joint venture arrangements should be avoided if possible so that the risk of losing control over that technology is minimized. Joint ventures involve more commitment than either exporting or licensing and have more risk and less flexibility associated with them.

Direct investment, unlike a joint venture, allows control over the operation. There need to be no concern that the lack of experience, commitment, judgment, or competence of a

partner will cause it to fail. Further, the shared management problems and the loss of flexibility associated with joint ventures is avoided.

Some of the same motivations for joint ventures apply to direct investment. It can be an approach to overcome political resentment of exporters exploiting a foreign market and the associated import restriction that either exist or may be threatened; it can also be a way to exploit local assets in terms of labour, raw materials, or facilities.

Direct and acquisition entry are both appropriate ways of entering a new market, they involve entirely different processes. It actually saves calendar time to choose acquisition to another local factory. Sometimes, it takes time to mount product development efforts, build production facilities, create distribution network, and gain market acceptance.

In terms of the financial implications for the entrant, direct entry is more likely to be fundable from internally generated funds, because of the typically incremental use of funds.

The SAG has implemented 7 years tariff phase down for textiles and clothing was introduced in 1995 and by September 1999, duties had been substantially reduced so that barriers of entry has reduced, it is favourable to direct entry.

Direct entry is typically more risky because there is no guarantee that there will ever be an ongoing business of the required size and profitability. The typically long initial period of start up losses imposes many strains and career risks.

However, cultural variances can cause major communication barriers. Based on the cross-cultural differences between China and South Africa, joint ventures and acquisition will create the communication gap. Managers from the home country need to identify, understand, and managerially interpret with the cultural force.

Based on the analysis provided in this study it is clear that China's foreign investors face a number of challenges in the manufacturing textile and clothing industry. There are a number of strategic approaches can adopt in meeting these challenges in South Africa. These strategies are either generic or specific in nature and to some extent also depend on the position that the MNC from China gone into the market. To effectively compete in its selected markets a combination of strategies are recommended.

4.3 GENERIC STRATEGIES

A company's competitive strategy consists of its business approaches and initiatives to attract customers and fulfil their expectations, to withstand competitive pressures, and to strengthen its market position. The core of a company's competitive strategy consists of its internal initiatives to deliver superior value to customers. But it also includes offensive and defensive moves to counter the manoeuvring of key rivals; actions to shift resources around to improve the firm's long-term competitive capabilities and market position, and tactical efforts to respond to the market conditions prevail at the moment. Generic strategies refer to foreign investors a general or broad orientation to competition and consist of two main approaches namely a low-cost leadership strategy and a broad differentiation strategy.

4.3.1 LOW-COST LEADERSHIP STRATEGY

Striving to be the textile and clothing industry's overall low-cost provider is a powerful competitive approach in markets where many buyers are price sensitive. The aim is to operate the business in a highly cost-effective manner and open up a sustainable cost advantage over local rivals.

There are a number of reasons to use a cost leadership strategy in textile and clothing industry:

- It can give the firm above-average returns even in the face of strong competitive forces.

- It can defend the firm against rivalry from local competitors because it is difficult for competitors to force the firm out on the basis of price.
- It can defend the firm against powerful buyers because buyers can exert pressure only to drive prices down to the level of the next most efficient competitor.
- It can defend the firm against powerful suppliers by providing flexibility to deal with input cost increases.
- It can put the firm in a favourable position to defend against substitutes from the firm's competitors.
- As a rule, the more price sensitive buyers are and the more inclined they are to base their purchasing decisions on which seller offers the best price, the more appealing a low-cost strategy becomes.

4.3.2 DIFFERENTIATION STRATEGIE

A differentiation strategy involves doing something so that the product is perceived as unique in the textile and clothing industry. There are many general approaches for accomplishing differentiation, for example brand image, design image, technology, quality image and features. As we illustrated in Chapter 2, the essence of a differentiation strategy is to be unique in ways that are valuable to customers and that can be sustained. The potential advantages to use differentiation strategy as follow:

- It can provide protection against competition because of brand loyalty by customers and their resulting willingness to support higher prices for brand items.
- It can increase margins because of the ability to charge a higher price.
- Through higher margins, it can provide flexibility for dealing with supplier power (such as raising the cost of raw materials).
- It can mitigate buyer power because there are no comparable alternatives
- Because of customer loyalty, it can put the company in a favourable position to fend against substitutes from competitors.

4.3.2 Best-Cost Provider Strategy

This strategy aims to become the low-cost provider of a product or service with good to excellent attributes, and then use the cost advantage to under price brands with comparable attributes.

Best Cost Provider emphasis on more than minimal quality, service, features and performance. The aim is to create competitive advantage by giving buyers more value for the money. This can be done by benchmarking, matching close rivals on key quality-service-features-performance attributes and beating them on the costs of incorporating such attributes into the product or service.

Each of these three strategic options represents an area that every business can usefully explore. As shown in Table 4.3, there are certain requirements for skills and resources intensive industry.

Generic strategy	Commonly Required Skills and Resources	Common Organizational Requirements
Overall cost leadership	<ul style="list-style-type: none">-Sustained capital investment and access to capital-Process engineering skills-Intense supervision of labour-Products designed for ease in manufacture-Low-cost distribution system	<ul style="list-style-type: none">-Tight cost control-Frequency, detailed control reports-Structured organization and responsibilities-Incentives based on meeting strict quantitative targets
Differentiation	<ul style="list-style-type: none">-Strong marketing abilities-Product engineering-Creative flair-Strong capability in basic research-Corporate reputation for quality of technological leadership-Long tradition in the industry or unique combination of skills drawn from other businesses-Strong cooperation from channels	<ul style="list-style-type: none">-Strong coordination among functions in R&D, product development, and marketing-Subjective measurement and incentives instead of quantitative measures-Amenities to attract highly skilled labour, scientists, or creative people
Best Cost Provider	<ul style="list-style-type: none">-Low-cost distribution channel-Sustained capital investment and access to capital-Process engineering skillsStrong marketing abilities	<ul style="list-style-type: none">-Benchmarking-Tight cost control-Innovation-Subjective measurement and incentives instead of quantitative measures-Structured organization and responsibilities

Table 4.3 Skills, resources, and organizational requirements of generic competitive strategies

4.4 HOW SUSTAINABLE IS THE COMPETITIVE ADVANTAGE?

Diversification is sometimes the only way to achieve growth for a company, or the only way to survive when sales and profitability of the core business are declining in their home country. Consequently, diversification is and will be a strategic option largely used to reach the long-term objectives planned to ensure the future of the firm.

Foreign investors from China with a huge commitment on their capital and resources, one of their competitive advantages will be their transfer of skill (transfer of product or process technology, transfer of marketing techniques) into the South African textile and clothing industry.

The reinforcement of the lowering costs and/or increasing differentiation leads to a better competitive position and consequently to higher profits.

Sustainable differentiation usually has to be linked to unique internal skills, core competencies, and capabilities. When a company has competences and capabilities that competitors cannot readily match and when its expertise can be used to perform activities in the value chain where differentiation potential exists, then it has a strong basis for sustainable differentiation.

The competitive advantage of a best-cost provider comes from matching close rivals on quality, service, features, performance and beating them on cost. To become a best-cost provider, a company must match quality at a lower cost than rivals, match features at a lower cost than rivals, match product performance at a lower cost than so on

4.5 ANALYSING ACCEPTABILITY

One of the primary objectives of an industry analysis is to determine the attractiveness of an industry to current and potential participants. Industry attractiveness, the industry's profit potential as measured by the long-term return on investment (ROI) achieved by its

participants, will provide an important input into the product-market investment decision.

ROI is based on forecasts of future financial returns from the proposed strategy, however, if we using a *low cost* provider strategy, the biggest pitfall is getting carried away with overly aggressively price-cutting and ending up with lower, rather than higher, profitability.

For Foreign investment companies, most of their core competences (raw material, equipment) will be imported from the home country. After a depreciation of some 19% (year-on-year) in the average value of the Rand against US dollar during 2001, a falling currency is likely to exert strong upward pressure on the general price level. It will affect their inputs cost increase.

Differentiation adds cost. The direct costs of differentiation include such elements as the costs of higher-quality inputs, the costs of larger inventories in order to guarantee speedy filling of orders. In addition there are indirect costs of differentiation, which arise through the interaction of differentiation variables with cost variables. To the extent that differentiation narrows the product-market scope of a firm, it also limits the potential for exploiting scale economies. To the extent that differentiation requires product innovation and the introduction of new models, it hampers the exploitation of experience curve economies. Sometimes, it is difficult to estimate the extra costs incurred in differentiation can be recovered from the customer.

Another consideration of the industry cost structure is to determine to what extent experience curve strategies are feasible in the industry. Can foreign firms from China develop sustainable cost advantages based on volume? Are there large fixed costs that would generate economies of scale?

Capacity utilization is a big cost driver for value chain activities that have substantial fixed costs associated with them. Higher rates of capacity utilization allow depreciation and other fixed costs to be spread over a larger unit volume, thereby lowering fixed costs per

unit. The more capital-intensive the business and / or the higher the percentage of fixed costs as a percentage of total costs, the more important this cost drive becomes because there's finding ways to operate close to full capacity on a year-round basis can be important source of cost advantage.

4.6 RISK ASSESSMENT

The overall level of risks reflects the vulnerability of key results if pivotal assumptions are wrong or critical tasks are not accomplished.

On the political front, there is the issue of political risk. SA tends to be greater in experiencing social unrest and disorder. Social unrest typically finds expression in strikes of the labour and causing violent conflict.

On the economic front, economic risks arise from economic mismanagement by the government of a country. One visible indicator of economic mismanagement tends to be the SA's higher inflation rate and higher interest rate with lower value of the currency. Unstable floating exchange rate diminishes the profit return from the foreign investors. It is difficult to adjust or predict their future profit margin.

In regard of legal front, risks arise when a country's legal system fails to provide adequate safeguards in the case of protect property rights or against crime and corruption. When legal safeguards are weak, the foreign investors are more likely to break the contracts and pull out the their investment in South Africa.

Will the forecast financial results be achieved and increase shareholder value?

A number of political, economic, and legal factors determine the costs of doing business in South Africa. With regard to political factors, the costs of doing business in S.A can be increased by a need to pay off the politically powerful in order to be allowed by the government to do business.

With regard to economic factors, one of the most important variables is the sophistication of a country's economy. It may be more costly to do business in SA because of the lack of skill-intensive labour and advanced technology. Investors from China need to transfer their expertise into S.A.

All strategy alternatives must eventually be tested for their financial attractiveness. The raw materials for this test are valid assumptions about the future revenues, costs and investment requirements to be achieved by each alternative.

4.7 LIMITATIONS

Any strategy needing new investment will be justified only if the promised returns are greater than the cost of capital. This process involves much more than a comparison of the promised financial results, using common criteria such as market share gains, payback of investment, or return on investment. However, in this research, we have limitation on the quantitative data. Clearly, the baseline strategy recommendations need to be considered suggestive and not definitive.

4.8 STRATEGY SELECTION

Strategies for multinational firms include exporting, licensing, joint ventures, and foreign direct investment. The choice involves in part a trade-off between flexibility versus commitment with its associated risk. The larger the share of textile and clothing market leaders; the more likely they are to react against entrants and the greater their market power to implement resistance. High levels of concentration should therefore favour acquisition entry as a means of avoiding both reaction and scale barriers. A joint venture provides political advantages and the use of a partner's assets and expertise but also involves commitment that will reduce flexibility. The substantial operational problems can be alleviated by using a dominant partner arrangement and by negotiating the business plan prior to finalizing the joint venture. Direct investment involves higher risks but provides control over the operation. In addition to investment recovery risks there are also risks to profitability caused by changing market conditions and government taxes and regulations.

Winning business strategies are grounded in sustainable competitive advantage. A company has competitive advantage whenever it has an edge over rivals in attracting customers and defending against competitive forces. To succeed in building a competitive advantage, a company's strategy must aim at providing buyers with what they perceive as superior value – a good product at a lower price or a better product that is worth paying more for.

It is not enough to understand that a company's basic competitive strategy options are overall low-cost leadership, broad differentiation, and best-cost producers. Foreign firms must also understand that the array of strategic options is narrowed and shaped by the nature of industry and competitive conditions and a firm's own competitive capabilities, market position, and best opportunities.

China's textile and clothing industry, is widely regarded as low-cost producer among the world's manufacturers. Despite its emphasis on product quality, most of the textile

factories have achieved absolute low-cost leadership because of its considerable skills in efficient manufacturing techniques and because the industry is positioned in the low-to medium end of the price spectrum where high production volumes are conducive to low unit costs. But for those diversify companies in order to compete in the host market, a classic best-cost producer strategy is the most appropriated.

A best-cost provider is the most powerful competitive approach for a parent company to implement into the new host market. It can pursued that the strive relentlessly to become a lower-and-lower-cost producer of a higher-and-higher-calibre product, aiming at eventually becoming the industry's absolute lowest-cost producer and, simultaneously, the producer of the industry's overall best product.

A best-cost producer strategy can be more advantageous than either a pure low-cost producer strategy or a pure differentiation strategy keyed to product superiority. This is because a best-cost provider can position itself near the middle of the market with either a medium-quality product at a below-average price or a very good product at a medium price. Often the majority of buyers prefer a midrange product rather than the cheap, basic product of a low-cost producer or the expensive product of a top-of the-line differentiator.

Other local/foreign competitors will invariably find ways to share the wealth of the market leader. Attractive opportunities always motivate competitors to try to match, leapfrog, or offset the advantage the leader has achieved. Thus, the anticipated extra profitability that a competitive advantage promises may not materialize or may quickly dry up.

Technology and communication are weaving together an interconnected planet, spreading the tools of economic and social progress, and equalizing the human condition. The barriers will be broken down, not just between economies and trade, but between people, giving it a shared interest in prosperity and peace.

4.9 CONCLUSION

Two critical organizational issues were discussed. First was the choice of home company form for entering South Africa (export, licensing, acquisition, joint ventures and foreign direct investment). These alternatives can be systematically evaluated using two sets of variables related to the industry environment, competitive situation. The industry environment variables emerging from the EAF are economic (market size and growth, cyclically, and intensity of the competitors), political (risk, regulatory control), and cultural (compatibility). To decide on the entry mode, the manager from home country ascertains which of the entry forms are favoured by the prevailing conditions of each of these variables, and then assesses the relative importance and interaction of these variables.

The second area evaluated the best generic strategies (cost leadership, differentiation and best-cost provider) for this dynamic textile industry. The test questions work best when there is a rich array of strategic alternatives from which to choose. The variety gives the parent company a basis for comparison and enhances creativity by suggesting combinations of different strategies.

CHAPTER 5

RECOMMENDATIONS

&

CONCLUSION

Far better an approximate answer to the right question, which is often vague, than an exact answer to the wrong question, which can always be made precise.

John Turkey,
Statistician, Princeton University

5.1 RECOMMENDATIONS

Being a major sector of the South Africa's economy, textile and clothing industry has been operating for years in a comfortable but unreal world, sheltered from overseas competition by high import tariffs. As a result, few local textile firms have felt the need to invest or deal with problems of over manning. However, the situation has changed dramatically. Tariffs have been progressively reduced and the market has opened up to outsiders.

South Africa actively encourages direct and indirect investment by non-resident persons and companies. Virtually all business activities are open to foreign investors and there are generally no restrictions on foreign investment. The prospects for superior profitability depend on the attractiveness of the market opportunity and the ability of business to gain and sustain a competitive advantage.

Although SAG encourages investments that strengthen, expand, or enhance technology in textile industries. At the same time, South Africa's tariff system is still consider as a complex structure and is subject to rapid change. SAG seems intent on conforming to the standards of the WTO, the legacy of an import substitution policy supported by high tariffs and import permits has left the South African apparel industry largely non-competitive on the world market. Due to this lack of competitiveness coupled with the high unemployment rate in South Africa, the government has vigorously explored WTO-permissible supply-side measures designed to facilitate worker re-training and technological innovation.

Companies having little power to lay off workers as well as finding appropriate black staffs to fill the quotas set by the employment equity legislation (affirmation actions). An abundant of unskilled labour cannot fulfil the labour-intensive textile industry.

The actual value of FDI remained fairly low largely because of the perception that the risk premium in South Africa was not being reduced by macroeconomic developments South Africa's image, the perception rather than the reality is being damaged by current problems

in Zimbabwe.

Corruption, ranging from demands for “facilitation” payments to bribes to secure major contracts, it is one of the most serious operational risks facing investors. There is often a gap between global principles and local realities, and it is essential for businesses to have an effective response to demands for bribery to ensure that they avoid entanglement in corruption which can bring legal sanctions at home without losing the commercially.

Through high rates of violent crime make it difficult for South African criminal and judicial entities to dedicate adequate resources to anti-corruption efforts, the government is committed to a tough stance on corruption. Crime has been a far more serious problem than either corruption or political violence, and an impediment to and a cost of doing business in SA.

The continuing weakness of the Rand might inhibit importers from placing orders overseas. The total textile industry will suffer from business lost to duty-free imports due to the various rebate facilities, fraudulent imports and possible increased imports due to the general reduction in customs duties.

Volume of production will be under pressure. Soft consumer demand and reduced disposable income will lead to fierce price competition and therefore a decline in local sales is expected.

Tax rates in South Africa were regarded as “excessively high” compared to other countries in transition. It puts South Africa at a disadvantage in the worldwide competition for FDI by making the cost of doing business higher than elsewhere.

Capitalizing on the mentioned constraints is a major challenge for the home country, because market imperfections and resource inadequacies abound. Rather than let these gaps and deficiencies stifle operations, the home country must see them as opportunities. Each one that a firm overcomes can be a source of competitive advantage. Solutions are not

easy or immediate, but finding ways to do without scarce resources or creating ways to carry out essential tasks can lead to superior results.

To be successful in the textile industry, the company coming into the country will need competency in strategic analysis and functional management. To meet the distinctive demands of the South Africa environments, it should recommend the capabilities that stand out as particularly critical in this particular situation..

The home country need to adopt a global strategic approach, seek to develop international competitive strengths which are not available to the domestic market. Such international strengths are based on (1) their experience curve with efficiencies of international scale and volume, that is, products and production processes geared to international markets; (2) the international transfer of lessons, ideas, and experience from one country to another; (3) an international image and reputation; (4) shifting financial and other resources from one part of the world to support operations in another; (5) superior access to place economies, such as low-cost raw materials, skills, labour, and other inputs; and (6) the ability to provide an international service. All of these depend on the firm's ability to coordinate its resources internationally.

Cost efficiency may no longer be a guarantee of security and profitability in today's fast-changing markets, but in almost all industries it is pre-requisite for success. In manufacturing textile and clothing industry where competition has always been primarily price-based, increasing intensity of competition is requiring more intensive and radical approaches to cost reduction.

Handling business-government relations carefully is essential to success in developing countries. Government is a mega-force; its actions permeate the business environment. Awareness is important of who the key government and political actors are, their goals and interest and the basis of their power. The home country must understand the host country's government official's perspective; the capacity to empathize is crucial to comprehension and communication. Understanding public policy is a prerequisite to formulating effective

strategies.

The parent company can shift production from one country to another to take advantage of exchange rate fluctuations, to enhance its leverage with host country governments, and to respond to changing wage rates, energy costs, or trade restrictions. They can enhance its brand reputation by consistently incorporating the same differentiating attributes in its products in all worldwide markets where it competes.

It is also important to cultivate a good relationship with customers, and associated with suppliers and distribution outlets. The ability to engage in joint problem solving is essential to coordinate numerous activities. Concentrate purchases on fewer suppliers in order to increase bargaining power and facilitate cooperation. Increase frequency of deliveries by suppliers to permit just-in-time component supply.

Managing change is a critical capability, because the business environment is often in a tumultuous state of flux, both economically and politically. The concentration of economic activities and the fragility of institutions expose the business environment to significant disruptions resulting from economic events, such as a large price drop in S.A major export or an eruption of inflation.

Unstable exchange rate and inflation in South Africa create problem areas in the financial environment. To manage under inflationary conditions, the parent company should set up their management information systems to monitor and forecast price changes. Accounting methods have to be adjusted to recognize the continual rise in costs; a focus on the future rather than the past is required. Foreign exchange exposure arises from shifts in a country's exchange rate. As with inflation, monitoring and predicting changes in the exchange rate become an important part of financial information flows. Since currency exchange rates vary in response to changing economic conditions, an international business must develop policies for dealing with exchange rate movement. A firm that adopts a wrong policy can lose large amounts of money, while a firm that adopts the right policy can increase the profitability of its international transactions.

Diversification raises the problem of the managerial and operational skills that need to be developed and reinforced over the next few years to guarantee the long-term prosperity of the firm. The expatriate from China must keep in mind that they not only manage a business portfolio, but also the first of all they have to manage a portfolio of resources and skills.

Establishing the firm's name and reputation plays a key role. A strong brand name serves as a proxy for quality and creates positive images in consumer's minds. It is significant and durable advantage because it represents a long history of superior value that cannot easily be matched by imitators. A strong brand name also helps for the MNC to deal with their export markets; it eases their extension into new markets or product categories.

Exploit economies of scale through concentrating production of each component type on single plant. Contract out production of all components where scales of production or run lengths are sub optimal, or where independent suppliers have technology advantages.

Increase labour productivity through automation. Improve capability utilization through improved sales forecasting and bigger promotions during seasonal downturns. To lower costs of quality control and warranties, reduce defects through improved employee morale and increase employee involvement.

Being culturally sensitive is essential to ensuring that a business's economic strategy is compatible with cultural dictates. International business is different because countries are different. It is important to understand how cultural differences across and within nations can affect the way in which business is practiced. Hofstede (1991) defined a relationship between specific cultural values. Chinese and the South Africa's unskilled and semi-skilled labours are tended to be more collectivism, in which people from birth onward are integrated into strong, cohesive groups (Table 5.1). Both countries are shown with high power distance, a belief that those who hold power are entitled to privileges. The difference in uncertainty avoidance in the two countries can often lead to cultural conflict between

managers and their superiors. The South African labours tend to be distrustful of new ideas or behaviours. Normally, they have high level of anxiety and stress and a concern with security and rule following. Conversely, Chinese people are willingness to take risks. Therefore, Chinese expatriates tend to be more masculinity than the local domestic workers.

Table 5.1 A comparison between S.A and Chinese’s culture

Hofstede’s model	South Africa	China
Individualism / Collective	Collective	Collective
Power distance	High	High
Uncertainly Avoidance	High	Low
Masculinity / Femininity	Femininity	Masculinity
Long-term / Short-term orientation	Short-term orientation	Long-term orientation

In order to minimize the conflict of two countries, communication is the important tool to bridge the relationship. Formal and informal communication channels can be utilised to foster the company’s own philosophy and ‘way of life’.

The concept of shared values or dominant beliefs underlies culture by specifying what is important. The values need to be shared by everyone in the organization so that they are reinforced and widely accepted.

The Chinese investors also need to be aware of strike activity happening in textiles industry in South Africa. Workers fight for wage increase during upswing and attempt to prevent reductions during the downswing. Investors need to build a balance of power between labour and capital depends upon the relative organizational strengths and attitudes of unions.

Managerial skills are also important in the context of diversification strategies. The management of a diversified company requires different managerial abilities in order to succeed in diverse businesses. The diversity or the strategic variety of business units can be assessed on several dimensions such as the required operational capabilities, the degree of turbulence of the environment, the degree of maturity of the demand. Due to the

cross-cultural differences, management team from China should recognise that they need to adjust to the organization structure and acquire new management skills. This could in turn result in a higher satisfaction for local employees and a more effective management of organizations.

The home company is able to shift resources, skills, technology, and products from one part of the world to another is in a position to bring the full weight of its international network to bear on specific competitors and / or opportunities. It is able to exert and that are beyond the capabilities and resources of individual subunit of the firm acting on their own. Therefore, the home and host company must build “trust” on their relationship.

Be able to compete with other local and foreign competitors, the host company must learn to adapt and upgrade, installing more advanced machinery, increasing their R&D and searching for niche markets. Investment in higher-quality inputs enables most host company to retain their competitive advantage, especially in more specialized markets. As textile industries move along their life cycles, they progress from a situation in which cheap disciplined labour is the foundation of competitive advantage to one in which technical knowledge and management skills are critical.

The host company from China need to implement the Total Quality Management (TQM). The most important person in the entire TQM process is the customer; basically, all efforts must be directed toward meeting this individual needs. Increased quality will help the firm develop a reputation and gain market share. It also sharply drives down costs and increases profits.

Being socially concerned is integral to responsible management. A developing country like S.A is beset with pressing socio-economic problems and social needs. The intensity and pervasiveness of poverty produce widespread human suffering. The home country must view their businesses as part of this larger community and define their responsibility as helping to meet community needs. In fact, social responsibility and ethical sensitivity are essential to strategic management.

Thinking globally is the final imperative, given the growing economic integration of the developing country. The parent company need to determine the roles that their LDC operations will play in their global production, marketing, and financing strategies and networks. Firms operating in only one country still need to have a global perspective for sourcing and for dealing with import competition. The managers from the host country should explore opportunities for creating new types of alliances and arrangements in and across the border or expand their business overseas.

5.2 CONCLUSION

One of the most important phenomena of the twentieth century has been the international expansion of industry. Today virtually all-major firms have a significant and growing presence in business outside their country of origin. China has been playing a key role within South Africa over the past 50 years, and has sought to consolidate her position as a leader of the developing world. S.A established diplomatic relations with the PRC on 01 January 1998. The basic of relations between PRC and S.A is the Pretoria Declaration signed by the two Presidents in 2000 and the Beijing Declaration signed following the Sino-Africa Conference in October 2000.

While recognizing the sincere and deep-rooted affinity China has towards Africa, it is equally true that China would benefit from African support to attain her high ambitions. Within the context of the African Renaissance, this creates an opportunity for Africa to consolidate and affirm a long-standing relationship with China, while also seeking fair opportunity in China for African enterprise. In creating a New Partnership between Africa and China on the basis of equality and mutual benefit, Africa can engage China in its renaissance.

The basic fact is that China is moving to the centre of the globalisation process, and both China and other nations (like South Africa) are benefiting from it. Man live in a world where technology, capital, and trade move increasingly more freely; where the old economic tools have lost their edge; and where economic strength and security increasingly depend on economic openness and integration. South Africa's path to growth and modernization is also a path to success.

Multinational company from China takes a long-term view of national opportunities and profitability in order to prepare with a heavy commitment of resources and personnel (capital and management) in pursuit of long-term market penetration. They need to recognize the task of managing in South Africa is differing from that of managing a purely

Chinese business in many ways. Countries differ in their cultures, political systems, economic systems, legal systems, and levels of economic development. It requires understanding the rules governing the international trading and investment system.

South Africa's trade and industrial policy has moved away from a highly protected, inward-looking economy towards an internationally competitive system that is able to capitalize on its comparative advantages. Enhancement of the competitiveness of industries on the domestic and international markets has consequently become a prime focus of the country's industrial policy.

Textile and clothing industry is one of the biggest light industries in South Africa, with the import incentives scheme (SMMDP), and a reduction of the textile industry tariff slowly allied with WTO and all the benefit gain from foreign trade agreements. One is the Southern African Development Community (SADC) Free Trade Agreements, which allows textiles to be traded duty-free among a number of countries within Southern Africa. The other one is EU-South Africa, Trade Development and Cooperation Agreement (TDCA) and the, most significant development is the US African Growth and Opportunity Act (AGOA). These trade agreements place South Africa in a unique position as the "economic giant of the African continent."

However, South Africa on the other hand, face with their enormous internal problems in their struggle to develop. Foreign direct investment plays a critical role in the development process. South Africa must develop a competitive, sustainable, fast-growing economy that creates national prosperity. The extent to which these challenges will relies on China enterprises transfers their multi-disciplinary knowledge in order to build a competitive industrial base with knowledge, innovation and productivity in South Africa.

The purpose of diversification is to build shareholder value. Diversification builds shareholder value when a diversified group of businesses can perform better under the auspices of a single corporate parent than they would as independent, stand-alone

businesses. The major disadvantage of direct investment is that the risks are usually high. The first are the macro-risks, those affecting the country as a whole. The second are micro-risks, those affecting only some industries of the foreign companies. Macro risks are the least common but the most visible. It involves political & economic uncertainties that can be a threat to the recovery of the investment. Micro-risks impact more on the profitability and cash flow than on asset recovery.

Managing in developing country, business-government relations should be approached strategically. Strategy will be determined by the company's relative bargaining power and the relative importance of the issues. The host company need to pay special attention to three operating aspects of managing business-government relations: designing and implementing the communications process, organizing responsibilities and functions for interacting with the government, and dealing with practical and ethical aspects of corruption.

Inflation and devaluation are the problem areas in the financial environment of S.A that are especially strategic because of their effects can be potentially devastating to the country. Therefore, the challenge for the home company is to avoid the myopia of defining inflation or devaluation as narrow technical problems and to recognize the larger implications for adjustments in a company's overall strategic plan.

To be successful in this competitive intense textile industry, a best-cost provider strategy has great appeal from the standpoint of competitive positioning. It produces superior customer value by balancing a strategic emphasis on low cost against a strategic emphasis on differentiation. A best-cost provider strategy will allow the new exported to penetrate the market. Increasing labour productivity and achieving economies of scale to keep unit cost down can preserve sustainability.

The research suggests that this investment in South Africa could result in a highly profitable business, if an appropriate strategic plan is adopted. The prospective enterprise from China must take advantage of the investment incentives, lower tariffs, competent and

low-wage workforce and the kaleidoscope of opportunities within the South Africa market to boost long-term profitability.

As with any emerging economy, there are always pros and cons to investing in that country. When analysing the various criteria, it is clear that South Africa is an attractive market with potential to expand. With SAG committed towards a market economy, the benefit of investing in South Africa far out-ways the limitations.

Therefore, it is recommended the parent company from China know how to ignore distractions and build their market power based on the core business.

APPENDIX I - Trade Countries

European Free Trade Association (EFTA)

Iceland
Liechtenstein
Norway
Switzerland

Southern African Development Community (SADC)

Angola
Botswana
Democratic Republic of Congo (DRC)
Lesotho
Malawi
Mauritius
Mozambique
Namibia
Seychelles
South Africa
Swaziland
Tanzania
Zambia
Zimbabwe

European Union (EU)

Austria
Belgium
Denmark
Finland
France
Germany
Greece
Ireland
Italy
Luxembourg
Netherlands
Portugal
Spain

Sweden

United Kingdom

Mercado Común del Sur (MERCOSUR)

Argentina

Bolivia

Brazil

Chile

Paraguay

Uruguay

Asia-Pacific Economic Cooperation (APEC)

Australia

Brunei

Canada

Chile

China

Hong Kong

Indonesia

Japan

Malaysia

Mexico

New Zealand

Papua New Guinea

Peru

Philippines

Russia / Russian Federation

Singapore

South Korea

Thailand

Vietnam

Taiwan

United States of America

North American Free Trade Area (NAFTA)

Canada

Mexico

United States of America

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